

Hero MotoCorp

17 October 2018

Reuters: HROM.BO; Bloomberg: HMCL IN

Performance In Line With Expectations

Hero MotoCorp (HML) reported 2QFY19 results which were in line with expectations as sales and margins came broadly in line while PAT at Rs9.8bn was 5% above our estimate because of higher other income. Net sales at Rs90.9bn grew 9% YoY on the back of 5.5% YoY volume growth and was marginally higher than our estimate. Realisation for the quarter grew 3% YoY and 2% QoQ. EBITDA margin for the quarter at 15.2% contracted ~220bps YoY and ~50bps QoQ and was in line with our estimate of 15.0%. The company, in the conference call, stated that while festive demand has been flattish, it is expected to pick up and has given guidance of 8%-10% volume growth for the full year. The company went for a price hike of Rs600-700/vehicle in October 2018. We have largely retained our FY19/FY20 estimates and also introduced FY21 estimates with a volume of 9.6mn units. We have rolled forward our target multiple to September 2020. HML's stock price has corrected ~16% in the past three months because of price war fears and market correction. We believe the stock price at current levels (it trades at 13.4x September 2020E earnings) looks attractive with limited downside. The stock at this price also gives a dividend yield of 3.0%-4.0%. With robust return ratios of ~30% and strong dividend yield, we believe HML is a good stock to enter at the current level. We have assigned Buy rating to the stock with a target price of Rs3,493 (16x September 2020E earnings).

Focus on new launches: HML is focusing on new launches in the scooter and premium segments to gain market share. It had a limited presence in the premium segment and recently launched Hero Xtreme 200R to gain market share in this segment. Further, the company will be launching two 125cc scooter models in the coming months to gain market share in the scooter category. We expect HML to launch more new models in the coming months as it has not been very aggressive in new launches versus competition. We expect fresh launches in the premium segment which, if successful, will drive the market share of company in that segment.

Valuation: HML stock price has corrected ~16% in the past three months because of price war fears and market correction. The company has retained its dominant position in the motorcycle market and despite competitive pricing pressure it has managed to generate operating margin upwards of 15%. We believe the stock price at current level (13.4x September 2020E earnings) looks attractive with limited downside. The stock at current level also gives a dividend yield of 3.0%-4.0%. With strong return ratios of ~30% and healthy dividend yield, we believe it is a good stock to enter at the current level. We have assigned Buy rating to the stock with a target price of Rs3,493 (16x September 2020E earnings) versus our earlier target price of Rs3,799.

BUY

Sector: Automobile

CMP: Rs2,895

Target Price: Rs3,493

Upside: 21%

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Key Data

Current Shares O/S (mn)	199.7
Mkt Cap (Rsbn/US\$bn)	578.2/7.9
52 Wk H / L (Rs)	3,895/2,692
Daily Vol. (3M NSE Avg.)	540,270

Price Performance (%)

	1 M	6 M	1 Yr
Hero MotoCorp	(9.1)	(23.9)	(23.3)
Nifty Index	(8.1)	0.5	3.5

Source: Bloomberg

Y/E March (Rsmn)	2QFY18	1QFY19	2QFY19	YoY (%)	QoQ (%)
Net revenues	83,717	88,098	90,909	8.6	3.2
Raw material costs	57,078	61,650	62,997	10.4	2.2
Gross profit	26,639	26,448	27,913	13.2	5.1
Staff costs	3,837	4,131	4,341	13.2	5.1
Other expenses	8,246	8,544	9,784	18.7	14.5
Total expenditure	69,160	74,325	77,122	11.5	3.8
EBITDA	14,557	13,773	13,787	(5.3)	0.1
EBITDAM (%)	17.4	15.6	15.2	(222bps)	(47bps)
Depreciation	1,360	1,482	1,518	11.6	2.4
Interest costs	16	21	21	37.2	1.4
Other income	1,176	1,157	2,237	90.2	93.3
PBT	14,357	13,427	14,485	0.9	7.9
Tax	4,252	4,336	4,722	11.0	8.9
Effective tax rate (%)	29.6	32.3	32.6	298bps	31bps
Net profit	10,105	9,092	9,763	(3.4)	7.4
NPM (%)	12.1	10.3	10.7	(133bps)	42bps
EPS (Rs)	50.6	45.5	48.9	(3.4)	7.4

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Revenues	2,85,005	3,22,305	3,61,212	4,01,266	4,46,406
YoY (%)	0.2	13.1	12.1	11.1	11.2
EBITDA	46,348	52,802	56,509	62,340	66,844
EBITDA (%)	16.3	16.4	15.6	15.5	15.0
PAT	33,771	36,974	38,234	42,178	45,023
YoY (%)	6.9	9.5	3.4	10.3	6.7
EPS (Rs)	169.1	185.1	191.5	211.2	225.5
RoE (%)	35.7	33.8	30.4	29.6	28.2
RoCE (%)	42.0	41.1	38.3	37.4	35.8
P/E (x)	17.1	15.6	15.1	13.7	12.8
EV/EBITDA	11.5	9.9	9.1	8.2	7.6
EV/Sales	1.9	1.6	1.4	1.3	1.1

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Change in our estimates

(Rsmn)	New estimates			Old estimates			Change (%)	
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E
Volume	82,22,413	90,53,769	96,40,277	83,91,599	91,47,491	-	(2.0)	(1.0)
Net sales	3,61,212	4,01,266	4,46,406	3,61,644	3,99,493	-	-	0.4
EBITDA	56,509	62,340	66,844	56,593	62,212	-	-	0.2
EBITDA margin (%)	15.64	15.5	15.0	15.65	15.6	-	-	-
PAT	38,234	42,178	45,023	38,200	42,145	-	-	-
EPS (Rs)	191.5	211.2	225.5	191.3	211.0	-	-	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Deviation of our estimates from actual performance in 2QFY19

(Rsmn)	Actual 2QFY19	Our estimate 2QFY19	Deviation %
Net sales	90,909	89,101	2.0
EBITDA	13,787	13,384	3.0
Net profit	9,763	9,291	5.1

Source: Nirmal Bang Institutional Equities Research

Conference-call key takeaways:

Demand: HML expects the softening demand momentum witnessed because of revised insurance norms to recover. The management expects 8%-10% growth in the festive season. It doesn't see higher petrol prices affecting demand or its new launches.

Market share: In 2QFY19, the company's market share in the deluxe segment improved while its overall market share remained largely unchanged.

New launches: The company launched Xtreme 200R nationally in the second quarter and has already sold ~6,000 volumes due to strong brand positioning. With the upcoming festive season, the company expects the launch to help consolidate its market leader position and more launches in the premium motorcycle segment are expected. In its scooter portfolio, its two 125cc models will be launched successively, one after the other.

Hero Fincorp: HML has a 42% stake in this company. Hero Fincorp currently finances 11% of HML's overall volume, compared to 11.5% in the preceding quarter. On an overall basis, 36.5% of HML's motorcycle sales are financed. The share of financing in the urban market stands in the range of 55%-60%, while the proportion stands lower in the rural market but is expected to increase going forward. The management stated that the recent NBFC problem is with large corporate loans and not with consumer loans catering to 24-month period EMIs.

Rural-urban demand: Rural demand has been marginally better than urban demand and going forward, the company's rural demand will get better, given the government impetus in the rural sector.

Spare parts: Spare part revenues for the quarter year stood at Rs7,130mn, a growth of ~24% YoY. For 1HFY19, the same stood at Rs13,150mn.

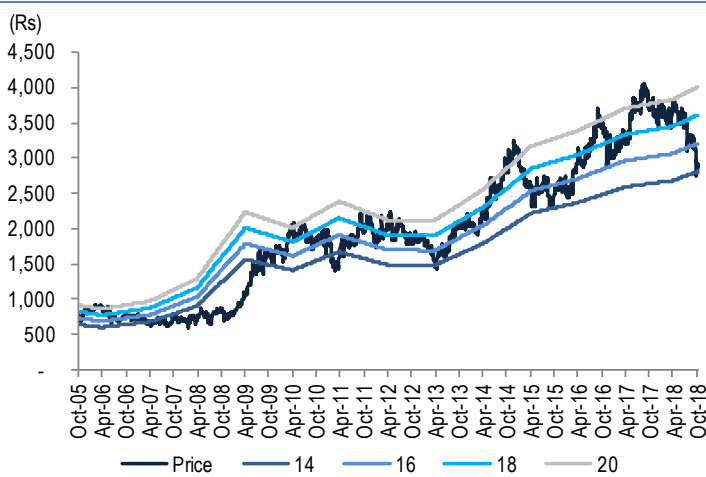
Exports: Exports have started picking up with 25% growth in 2QFY19. The company expects its export volume to improve in the coming years as it is witnessing good improvement in markets like Bangladesh and Central America.

Price hike: The company went for a Rs600-Rs700/vehicle price hike in October 2018. As per the management, the price hikes over the past few months are being absorbed by the market and further price hike will depend upon how commodity prices will pan out in the future. The company has given long-term EBITDA margin guidance in the range of 14%-16%.

Inventory level: Inventory level of the company remained in the range of four to six weeks, indicating strong retail demand across scooter and motorcycle segments.

Others: Other income during the quarter rose sharply YoY and QoQ as the interest money from income-tax deposits increased sequentially as well as versus the same quarter last year.

Exhibit 4: P/E charts



Source: Nirmal Bang Institutional Equities Research



Source: Nirmal Bang Institutional Equities Research

Financials (standalone)

Exhibit 5: Income statement

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Net sales	2,85,005	3,22,305	3,61,212	4,01,266	4,46,406
% growth	0.2	13.1	12.1	11.1	11.2
Raw material costs	1,90,373	2,18,346	2,45,150	2,73,997	2,99,284
Staff costs	13,960	15,401	17,493	19,683	25,489
Other expenses	34,324	35,755	42,060	45,246	54,789
Total expenditure	2,38,657	2,69,503	3,04,703	3,38,926	3,79,562
EBITDA	46,348	52,802	56,509	62,340	66,844
% growth	4.0	13.9	7.0	10.3	7.2
EBITDA margin (%)	16.3	16.4	15.6	15.5	15.0
Other income	5,224	5,258	5,731	6,419	7,125
Interest costs	61	63	63	63	63
Gross profit	94,632	1,03,959	1,16,061	1,27,269	1,47,122
% growth	3.6	9.9	11.6	9.7	15.6
Depreciation	4,927	5,556	5,885	6,636	7,474
Profit before tax	46,585	52,442	56,292	62,060	66,433
% growth	5.0	12.6	7.3	10.2	7.0
Tax	12,813	15,468	18,058	19,882	21,409
Effective tax rate (%)	27.5	29.5	32.1	32.0	32.2
Net profit	33,771	36,974	38,234	42,178	45,023
% growth	6.9	9.5	3.4	10.3	6.7
Extraordinary items	-	-	-	-	-
Reported net profit	33,771	36,974	38,234	42,178	45,023
% growth	6.9	9.5	3.4	10.3	6.7
EPS (Rs)	169.1	185.1	191.5	211.2	225.5
% growth	6.9	9.5	3.4	10.3	6.7
DPS (Rs)	87.0	85.0	90.0	105.0	115.0
Payout (%)	51.4	45.9	47.0	49.7	51.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
Equity	399	399	399	399	399
Reserves	1,00,714	1,17,289	1,33,742	1,50,682	1,68,065
Net worth	1,01,113	1,17,689	1,34,141	1,51,081	1,68,464
Net deferred tax liability	4,143	5,117	5,117	5,117	5,117
LT liabilities/provisions	753	1,149	1,149	1,149	1,149
Liabilities	1,06,010	1,23,955	1,40,407	1,57,347	1,74,730
Gross block	1,03,772	1,11,344	1,25,344	1,39,344	1,53,344
Depreciation	59,816	64,799	70,684	77,321	84,795
Net block	43,956	46,545	54,660	62,023	68,550
Capital work-in-progress	4,651	3,184	3,184	3,184	3,184
Intangible assets	-	-	-	-	-
Long-term investments	13,490	19,341	22,441	24,941	28,441
Other long-term assets	10,314	9,836	11,386	14,386	17,386
Inventories	6,563	8,236	8,630	10,127	11,856
Debtors	15,619	15,202	17,368	19,298	21,453
Cash	1,367	1,413	1,710	2,270	3,193
Liquid investments	45,409	55,911	59,911	62,911	65,911
Other current assets	5,574	7,720	7,975	9,400	11,047
Total current assets	74,532	88,482	95,594	1,04,006	1,13,460
Creditors	40,543	42,835	46,300	50,571	55,594
Other current liabilities/provisions	390	598	559	621	696
Total current liabilities	40,933	43,433	46,858	51,192	56,290
Net current assets	33,599	45,049	48,736	52,813	57,170
Total assets	1,06,009	1,23,955	1,40,407	1,57,347	1,74,730

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY17	FY18	FY19E	FY20E	FY21E
EBIT	46,645	52,504	56,355	62,123	66,495
(Inc.)/dec. in working capital	3,993	1,601	609	(517)	(434)
Cash flow from operations	50,638	54,105	56,964	61,606	66,061
Other income	5,163	5,216	5,731	6,419	7,125
Other expenses	1,742	307	-	-	-
Depreciation	4,927	5,556	5,885	6,636	7,474
Tax paid	11,865	14,943	18,058	19,882	21,409
Net cash from operations	40,280	39,809	39,060	41,941	45,001
Capital expenditure	(11,491)	(7,992)	(14,000)	(14,000)	(14,000)
Net cash after capex	28,790	31,816	25,060	27,941	31,001
Other investment activities	(7,949)	(11,160)	(2,919)	(2,081)	(2,375)
Cash from financial activities	(20,956)	(20,467)	(21,694)	(25,300)	(27,703)
Opening cash balance	269	154	344	790	1,351
Closing cash balance*	154	344	790	1,351	2,273
Change in cash balance	(115)	190	447	560	923
*Unpaid dividend/unrealised exchange gains	1,214	1,070	920	920	920

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

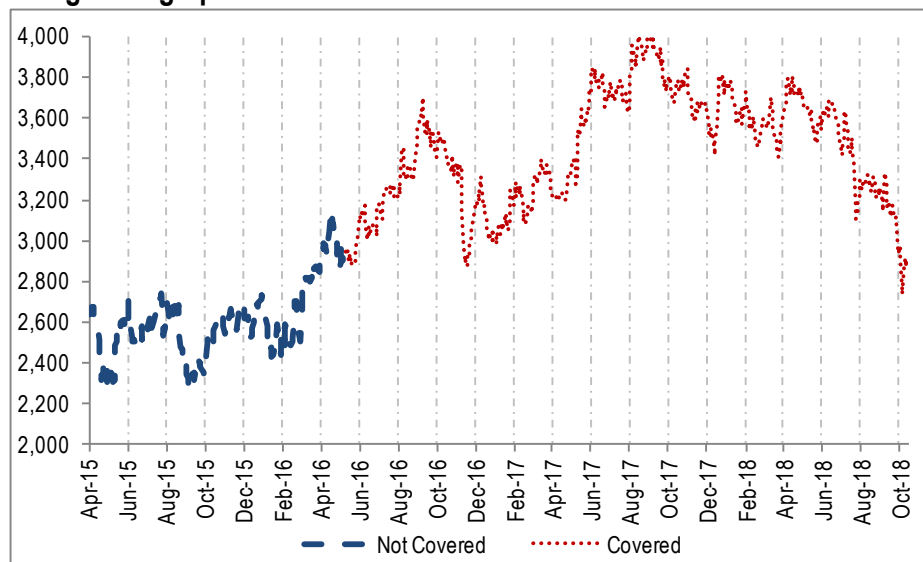
Y/E March	FY17	FY18	FY19E	FY20E	FY21E
Profitability & return ratios					
EBITDA margin (%)	16.3	16.4	15.6	15.5	15.0
EBIT margin (%)	14.5	14.7	14.0	13.9	13.3
Net profit margin (%)	11.8	11.5	10.6	10.5	10.1
RoE (%)	35.7	33.8	30.4	29.6	28.2
RoCE (%)	42.0	41.1	38.3	37.4	35.8
Working capital & liquidity ratios					
Receivables (days)	19	18	18	18	18
Inventory (days)	9	9	9	9	10
Payables (days)	57	56	55	54	53
Cash conversion cycle (WC days)	(30)	(30)	(29)	(27)	(26)
Current ratio (x)	1.8	2.0	2.0	2.0	2.0
Quick ratio (x)	1.7	1.8	1.9	1.8	1.8
Valuation ratios					
EV/Sales (x)	1.9	1.6	1.4	1.3	1.1
EV/EBITDA (x)	11.5	9.9	9.1	8.2	7.6
P/E (x)	17.1	15.6	15.1	13.7	12.8
P/BV (x)	5.7	4.9	4.3	3.8	3.4

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
26 May 2015	Buy	2,588	2,981
18 June 2015	Buy	2,525	2,981
9 July 2015	Buy	2,550	2,981
9 October 2015	Buy	2,545	3,023
23 October 2015	Buy	2,606	3,044
9 May 2016	Accumulate	2,893	3,104
9 August 2016	Accumulate	3,457	3,396
28 October 2016	Accumulate	3,314	3,655
3 January 2017	Buy	3,008	3,409
10 February 2017	Buy	3,265	3,596
12 May 2017	Accumulate	3,462	3,863
26 July 2017	Accumulate	3,709	4,081
2 November 2017	Accumulate	3,819	4,275
7 February 2018	Buy	3,542	4,115
3 May 2018	Accumulate	3,664	4,104
26 July 2018	Buy	3,110	3,799

Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

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