

Institutional Equity Research

Hero MotoCorp

Automobile | India

Event Update | December 13, 2018

CMP* (Rs)	3,318
Upside/ (Downside) (%)	5
Bloomberg Ticker	HMCL IN
Market Cap. (Rs bn)	662.6
Free Float (%)	65
Shares O/S (mn)	200

HOLD 
Target Price: Rs3,500

Higher Competitive Intensity & Limited Upside Justify Rating Downgrade

Hero MotoCorp (HMCL) has been delivering a subdued performance on volume front since past few months. Industry's competitive intensity has been rising steadily since the beginning of FY19. Our recent channel check indicates that overall retail sales declined during 40 days of festival for HMCL, which transformed into higher level of inventory for the company post festival. We believe that higher inventory coupled with competitive pricing would result in margin pressure for the industry including HMCL, going forward. Moreover, recent price run up leaves limited upside from the current level. Current valuation at 15.2x FY20E EPS is broadly close to its fair valuation. **Thus, we downgrade our recommendation on the stock to HOLD from BUY, while maintaining our estimates and Target Price of Rs3,500.**

Higher Inventory and Market share Fall to Force on Pricing Action

Overall inventory level across 2W industry is 1-2 week higher than the normal level, which further increased pricing pressure within the industry. Led by Bajaj Auto's aggressive pricing strategy on entry-level motorcycles, HMCL's ~1/3rd of product portfolio got impacted as HMCL has a stronger presence in entry-level motorcycles. We believe that constant market share fall witnessed by HMCL would force the Management to take pricing action to arrest fall in market share. HMCL has been witnessing decent growth until 1HFY19 despite steady fall in market share. However, we believe that, it will be difficult for HMCL to maintain recent growth momentum in 2HFY19 amid subdued festive sales. We believe that this situation would encourage the Management to take pricing action on few models to regain lost growth momentum.

New Products to Cushion Volume but Difficult to Pass on Cost Escalation

Looking ahead, we expect strong product line-up in scooter and premium bike segment would cushion overall volume for HMCL. The Management exuded confidence on superior product quality and brand equity over the competitor's aggressive pricing strategy in its earnings conference call and aimed a double-digit volume growth in FY19. We believe that it would be challenging for the Company to achieve double digit volume growth in FY19E. We expect negative impact of competition on HMCL's realisation, margins and profitability, going forward, which would further restrict the Company from passing on cost inflation to customers by price hikes. HMCL's margins would be under pressure on account of likely price revision/discounting on selected products by the company, in our view.

Outlook & Valuation

We maintain our estimates for FY19E and FY20E and retain our target price of Rs3500 per share, valuing the stock at 16x FY20E EPS. Post recent price run-up, the stock currently trades at 17.8x FY19E and 15.2x FY20E EPS, which is close to our targeted fair valuation multiple, which leaves limited upside of ~5% from the current level. Further, we believe that risk reward is becoming unfavourable with increasing challenging business environment for the 2W players. **Thus, we downgrade our recommendation on the stock to HOLD from BUY.**

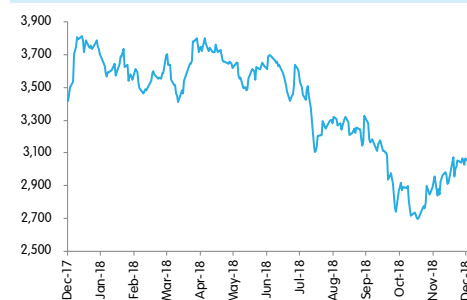
Key Financials (Rs mn)	FY17	FY18	FY19E	FY20E
Net Sales	284,750	322,305	350,158	400,128
EBITDA	46,439	52,893	54,221	62,838
EBITDA margin (%)	16.3	16.4	15.5	15.7
Adj. Net Profit	33,819	37,002	37,147	43,686
EPS (Rs.)	169.4	185.3	186.0	218.7
YoY growth (%)	7.0	9.4	0.4	17.6
RoE (%)	32.2	30.9	27.3	27.7
RoCE (%)	31.2	29.8	26.3	26.9
PER (x)	19.6	17.9	17.8	15.2
EV/ EBITDA	14.2	12.5	12.2	10.5

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	15.2	4.9	(3.0)
Relative to Nifty	13.2	10.0	(8.8)

Shareholding Pattern (%)	Jun'18	Sep'18
Promoter	34.6	34.6
Public	65.4	65.4

1 Year Stock Price Performance



Note: * CMP as on December 13, 2018

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Risk to the view

- ▶ **Downside Risks:** Any major economic slowdown or unfavourable whether condition for upcoming crop seasons; higher competitive intensity; sharp rise in input cost, slowdown in its key exports geographies; change in government regulation.
- ▶ **Upside Risks:** Major success of new launch and sharp fall in commodity prices.

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Profit & Loss Statement

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E
Net revenue	284,750	322,305	350,158	400,128
Expenditure	238,311	269,412	295,938	337,291
Raw Materials	190,118	218,346	241,885	274,888
Employee Expenses	13,960	15,401	17,240	19,309
Other expenditure	34,233	35,664	36,813	43,094
EBITDA	46,439	52,893	54,221	62,838
Depreciation and amortization expense	4,927	5,556	6,206	6,599
EBIT	41,512	47,337	48,015	56,239
Non-operating income	5,181	5,196	6,574	7,494
Interest including finance charges	61	63	93	115
Adjusted pre-tax profit	46,633	52,470	54,496	63,618
Add: Extraordinary Income	(48)	(28)	-	-
Reported pre-tax profit	46,585	52,442	54,496	63,618
Less: taxes	12,813	15,468	17,349	19,932
Reported net profit	33,771	36,974	37,147	43,686
Adjusted net profit for shareholders	33,819	37,002	37,147	43,686
EPS (Rs), based on wtd avg shares	169.4	185.3	186.0	218.7
EPS (Rs), based on fully diluted shares	169.4	185.3	186.0	218.7
Year-end shares outstanding (mn)	200	200	200	200
Fully diluted shares outstanding (mn)	200	200	200	200

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Balance Sheet

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E
Equity capital	399	399	399	399
Reserves and surplus	100,714	117,289	135,208	159,666
Total equity	101,113	117,689	135,607	160,065
Deferred tax liability (net)	4,143	5,117	5,117	5,117
Current liabilities	41,686	44,583	46,518	50,557
Total liabilities	146,943	167,388	187,241	215,739
Cash and cash equivalents	1,367	1,413	710	278
Inventory	6,563	8,236	8,919	10,165
Trade receivables	15,619	15,202	16,309	17,540
Other current assets	15,889	17,556	18,529	19,579
Total current assets	39,438	42,407	44,466	47,562
Gross block	68,580	75,738	89,322	101,522
Less: depreciation and amortization	24,624	29,193	35,399	41,998
Add: capital work-in-process	4,651	3,184	2,600	2,400
Total fixed assets	48,606	49,729	56,523	61,924
Investments	58,899	75,252	86,252	106,252
Total assets	146,943	167,388	187,241	215,739

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Cash Flow Statement

Y/E Mar (Rs mn)	FY17	FY18	FY19E	FY20E
Operating cashflow				
Pre-tax income	46,585	53,151	54,496	63,618
Add: depreciation and amortization	4,927	5,556	6,206	6,599
Add: interest expense (net)	61	63	93	115
Less: other adjustments	(3,636)	(1,336)	0	0
Less: taxes paid	(11,865)	(14,943)	(17,349)	(19,932)
Add: working capital changes	4,208	(2,682)	(828)	511
Total operating cashflow	40,280	39,809	42,617	50,911
Investing cashflow				
Capital expenditure	(11,491)	(8,018)	(13,000)	(12,000)
Investments	(9,917)	(11,923)	(11,000)	(20,000)
Others	1,969	789	-	-
Total investing cashflow	(19,439)	(19,152)	(24,000)	(32,000)
Financing cashflow				
Share issuances	15	27	-	-
Dividend	(20,910)	(20,431)	(19,228)	(19,228)
Interest Payment	(61)	(63)	(107)	(129)
Less: Others	169	(144)	-	0
Total financing cashflow	(20,787)	(20,611)	(19,335)	(19,357)
Net change in cash	54	46	(717)	(446)
Opening cash	1,314	1,367	1,427	724
Closing cash	1,367	1,413	710	278

Key Ratios

Y/E March	FY17	FY18	FY19E	FY20E
Growth Ratios (%)				
Net revenue	0.1	13.2	8.6	14.3
EBITDA	3.6	13.9	2.5	15.9
Adjusted net profit	7.0	9.4	0.4	17.6
Ratios (%)				
Effective tax rate	27.5	29.5	31.8	31.3
EBITDA margin	16.3	16.4	15.5	15.7
Adjusted net income margin	11.9	11.5	10.6	10.9
ROaCE	31.2	29.8	26.3	26.9
ROaE	32.2	30.9	27.3	27.7
Total asset turnover ratio (x)	1.9	1.9	1.9	1.9
Inventory days	8	9	9	9
Debtor days	20	17	17	16
Creditor days	50	45	43	42
Per share numbers (Rs)				
Diluted earnings	169.4	185.3	186.0	218.7
Free cash	144.2	159.2	148.3	194.8
Book value	506.3	589.3	679.0	801.4
Valuations (x)				
P/E	19.6	17.9	17.8	15.2
EV/EBITDA	14.2	12.5	12.2	10.5
P/B	6.6	5.6	4.9	4.1

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Rating History

Date	Reco	CMP	TP
26-Jul-18	BUY	3,137	3,500
3-May-18	BUY	3,656	4,200

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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