

SELL

TP: Rs 2,900 | ▼ 16%

HERO MOTOCORP

Automobiles

05 February 2021

Optimism priced in – maintain SELL

Hero MotoCorp's (HMCL) Q3FY21 operating performance beat estimates due to above-expected gross margins. Revenue grew 40% YoY to Rs 97.8bn and EBITDA margin came in at 14.5% (12.4% est.). We expect operating performance to come under pressure given steep RM cost increases coupled with a likely QoQ drop in volumes. We continue to model for a 17% earnings CAGR over FY21-FY23 and retain our Mar'22 TP of Rs 2,900. Maintain SELL as current valuations look full at 18x FY23E EPS.

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Operational beat: Q3 revenue at Rs 97.8bn (+40% YoY) came in marginally ahead of our estimate of Rs 94bn, driven by a strong 17% YoY jump in ASP while volumes for the quarter grew 20% YoY. Sequential improvement in gross margin and better operating efficiencies led to a 210bps beat on EBITDA margin to 14.5%. Adj. PAT grew 23% YoY to Rs 10.8bn, 27% ahead of our projection supported by above-expected other income.

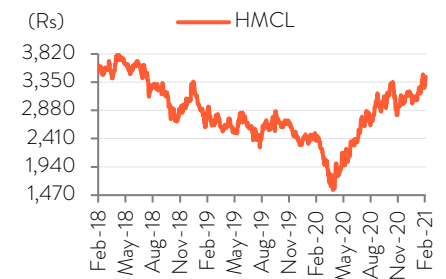
Near-term margin headwinds: With inventories at regular levels, sustainability of production will now depend on a pickup in retail sales. In addition, we remain cautious on operating margin performance as we believe the sharp rise in prices of key inputs such as aluminium and steel is likely to weaken gross margins by >200bps in Q4 from Q3 levels of 29.5%. HMCL took a blended price increase of ~2% in Oct'20 but would need further hikes to fully offset raw material cost inflation.

Maintain SELL: We expect HMCL to clock a revenue/EBITDA/PAT CAGR of 12%/15%/17% during FY21-FY23. In our view, most positives are priced in at current valuations of 18x FY23E EPS. Maintain SELL with a Mar'22 TP of Rs 2,900, which values the stock at an unchanged 15x one-year forward EPS.

Ticker/Price	HMCL IN/Rs 3,441
Market cap	US\$ 9.4bn
Shares o/s	200mn
3M ADV	US\$ 59.1mn
52wk high/low	Rs 3,520/Rs 1,475
Promoter/FPI/DII	35%/32%/19%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	336,505	288,361	307,895	349,030	384,492
EBITDA (Rs mn)	49,301	39,580	38,115	44,583	49,973
Adj. net profit (Rs mn)	33,849	29,559	28,141	33,939	38,283
Adj. EPS (Rs)	169.5	148.0	140.9	170.0	191.7
Adj. EPS growth (%)	(8.5)	(12.7)	(4.8)	20.6	12.8
Adj. ROAE (%)	26.3	20.9	17.6	19.1	19.2
Adj. P/E (x)	20.3	23.2	24.4	20.2	17.9
EV/EBITDA (x)	13.9	17.3	18.0	15.1	13.6

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY21	Q3FY20	YoY (%)	Q2FY21	QoQ (%)	9MFY21	9MFY20	YoY (%)
Volume	1,845,274	1,540,876	19.8	1,814,683	1.7	4,223,383	5,075,216	(16.8)
Avg. Realisation per Vehicle (Rs)	52,977	45,407	16.7	51,620	2.6	52,362	44,526	17.6
Net Revenues	97,758	69,967	39.7	93,673	4.4	221,147	225,977	(2.1)
Total Income (A)	97,758	69,967	39.7	93,673	4.4	221,147	225,977	(2.1)
Operating Expenses:								
Raw materials consumed	68,912	46,598	47.9	66,600	3.5	156,451	153,775	1.7
Employee Expenses	5,167	4,697	10.0	5,112	1.1	14,103	14,063	0.3
Other Expenses	9,543	8,282	15.2	9,097	4.9	22,512	25,159	(10.5)
Total Expenditure (B)	83,621	59,578	40.4	80,809	3.5	193,066	192,996	0.0
EBITDA (A-B)	14,136	10,390	36.1	12,864	9.9	28,081	32,981	(14.9)
Other Income	2,027	1,822	11.2	1,413	43.4	4,925	6,089	(19.1)
Depreciation	1,698	2,037	(16.6)	1,732	(1.9)	5,138	6,433	(20.1)
EBIT	14,465	10,175	42.2	12,546	15.3	27,868	32,637	(14.6)
Finance Costs	47	59	(21.5)	46	0.2	156	180	(13.4)
PBT before excep items	14,418	10,115	42.5	12,500	15.4	27,713	32,457	(14.6)
Exceptional items	-	-	-	-	-	-	(6,773)	(100.0)
PBT after excep items	14,418	10,115	42.5	12,500	15.4	27,713	39,230	(29.4)
Tax expense	3,574	1,311	172.5	2,965	20.5	6,720	9,106	(26.2)
Reported PAT	10,845	8,804	23.2	9,535	13.7	20,992	30,125	(30.3)
Adjusted PAT	10,845	8,804	23.2	9,535	13.7	20,992	23,352	(10.1)
Adj EPS (Rs)	54.3	44.1	23.2	47.7	13.7	105	116.9	(10.1)

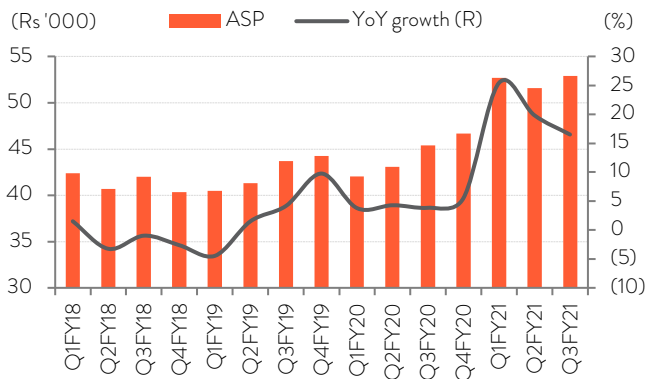
Source: Company, BOBCAPS Research

FIG 2 – KEY PARAMETERS

(%)	Q3FY21	Q3FY20	YoY (bps)	Q2FY21	QoQ (bps)	9MFY21	9MFY20	YoY (bps)
Gross margin	29.5	33.4	(389)	29	61	29.3	32.0	(270)
EBITDA margin	14.5	14.8	(39)	14	73	12.7	14.6	(190)
EBIT margin	14.8	14.5	25	13	140	12.6	14.4	(184)
PBT margin	14.7	14.5	29	13	141	12.5	14.4	(183)
Tax rate	24.8	13.0	1182	24	106	24.2	23.2	104
Adj PAT margin	11.1	12.6	(149)	10	91	9.5	10.3	(84)

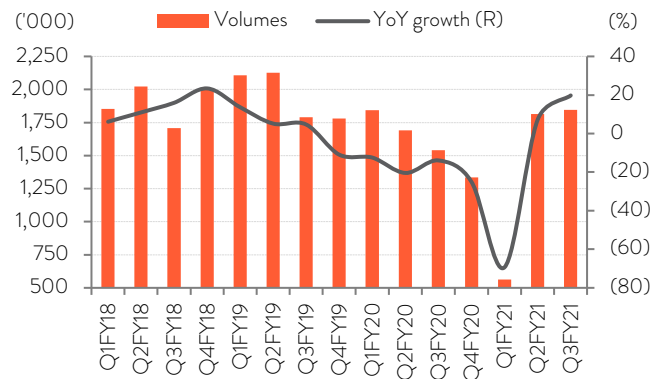
Source: Company, BOBCAPS Research

FIG 3 – AVERAGE SELLING PRICE (ASP)



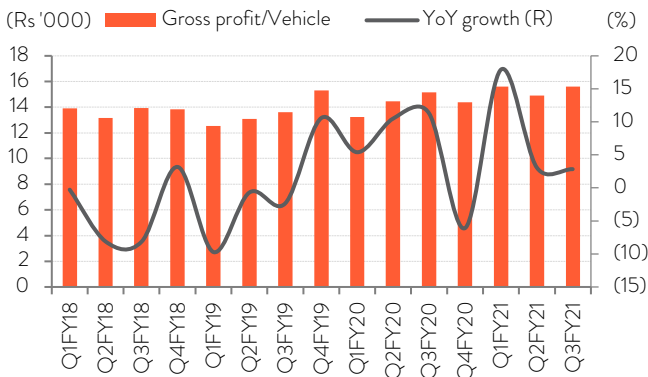
Source: Company, BOBCAPS Research

FIG 4 – VOLUME GROWTH TREND



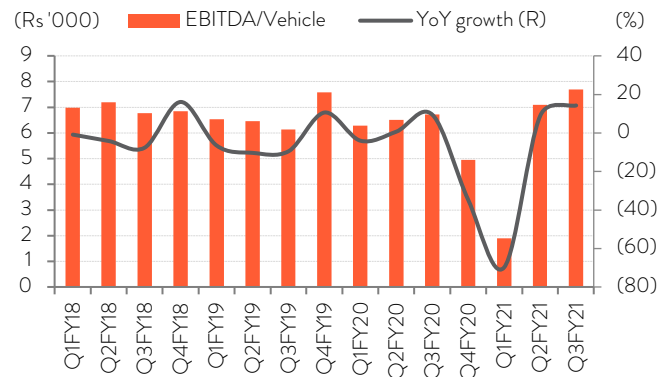
Source: Company, BOBCAPS Research

FIG 5 – GROSS PROFIT/VEHICLE



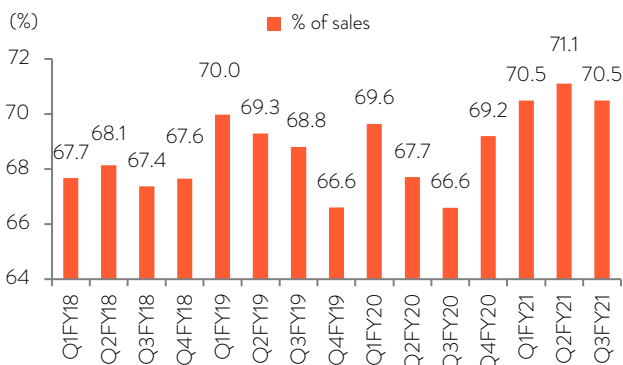
Source: BOBCAPS Research, Company

FIG 6 – EBITDA/VEHICLE



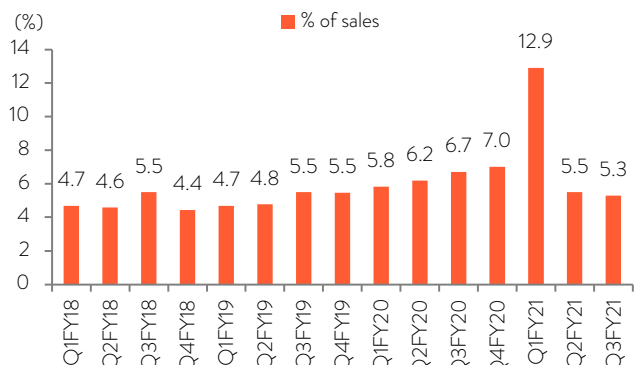
Source: BOBCAPS Research, Company

FIG 7 – RM COST/SALES TREND

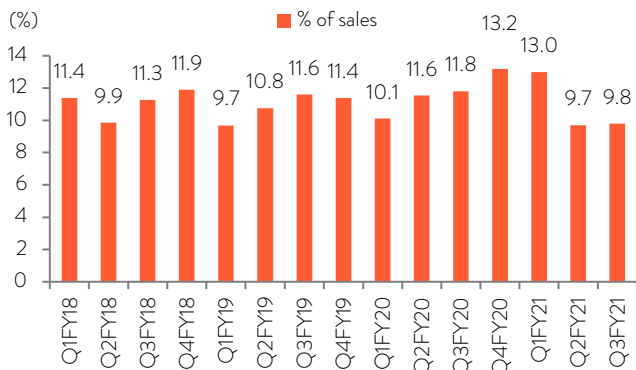


Source: Company, BOBCAPS Research

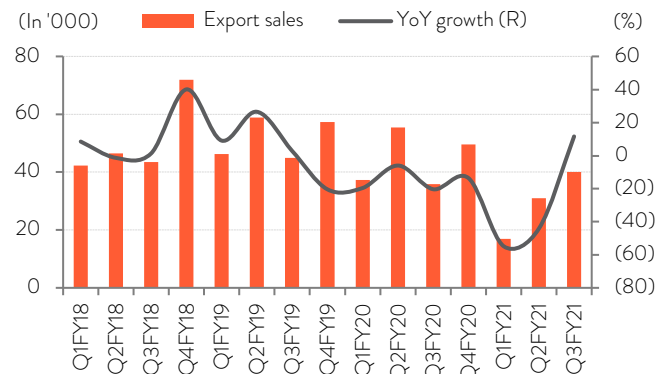
FIG 8 – EMPLOYEE COST/SALES TREND



Source: Company, BOBCAPS Research

FIG 9 – OTHER EXPENSES/SALES TREND

Source: Company, BOBCAPS Research

FIG 10 – EXPORTS VOLUME TREND

Source: Company, BOBCAPS Research

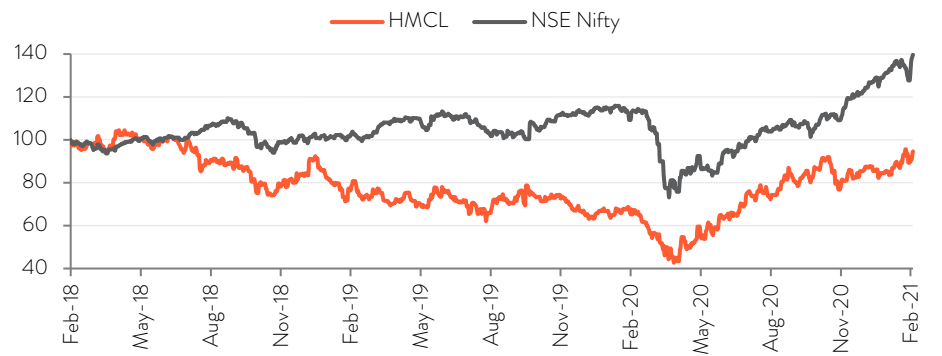
Earnings call highlights

- HMCL stated that it has gained ~190bps market share in the domestic market and ~90bps in exports during Q3FY21.
- Management believes that pent-up demand has now been catered to and macro fundamentals would drive demand going ahead. Also, personal mobility needs have surged given social distancing norms and limited public transport facilities, which should benefit the company.
- ASP expansion in Q3 was led by the price increase taken in Oct'20 and also a better product mix.
- Commodity prices are expected to trend upwards but management is confident of tackling this via better cost management and price hikes.
- HMCL's LEAP-II programme aided cost savings of ~125bps (as a percentage of sales) in Q3.
- Inventory levels which were at about four weeks post festive season have now normalised to around six weeks.
- Spare parts revenue for the quarter stood at Rs 10bn and other operating revenue was at Rs 1.9bn.
- Financing of vehicles stood at ~50% in Q3 of which Hero Fincorp commanded 40% share.

Valuation methodology

We expect HMCL to clock a revenue/EBITDA/PAT CAGR of 12%/15%/17% during FY21-FY23. In our view, most positives are priced in at current valuations of 18x FY23E EPS. Maintain SELL with a Mar'22 target price of Rs 2,900, which values the stock at an unchanged 15x one-year forward EPS.

FIG 11 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- A sharp rise in financing ratio for 2Ws along with favourable credit terms such as extension of loan tenures may reduce the expected negative impact on 2W demand.
- Above-expected pickup in rural demand on the back of good monsoons would disproportionately benefit HMCL given its higher volume mix from these markets, posing an upside risk to our volume estimates.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	336,505	288,361	307,895	349,030	384,492
EBITDA	49,301	39,580	38,115	44,583	49,973
Depreciation	6,020	8,180	6,843	7,382	8,240
EBIT	50,193	39,184	37,841	45,592	51,400
Net interest income/(expenses)	(86)	(220)	(220)	(220)	(220)
Other income/(expenses)	6,913	7,783	6,570	8,392	9,667
Exceptional items	(934)	6,774	0	0	0
EBT	49,173	45,737	37,621	45,372	51,180
Income taxes	16,259	9,404	9,481	11,434	12,897
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	32,915	36,333	28,141	33,939	38,283
Adjustments	934	(6,774)	0	0	0
Adjusted net profit	33,849	29,559	28,141	33,939	38,283

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	34,556	30,305	37,320	44,920	41,237
Other current liabilities	6,158	7,990	4,496	9,880	5,596
Provisions	590	2,689	2,689	2,689	2,689
Debt funds	0	0	0	0	0
Other liabilities	1,172	1,217	1,217	1,217	1,217
Equity capital	400	400	400	400	400
Reserves & surplus	128,172	140,965	159,063	177,026	199,334
Shareholders' fund	128,572	141,364	159,462	177,426	199,734
Total liabilities and equities	171,047	183,565	205,184	236,133	250,472
Cash and cash eq.	1,365	2,419	11,807	3,041	2,027
Accounts receivables	28,216	16,031	27,711	27,922	30,759
Inventories	10,724	10,920	11,084	13,263	13,842
Other current assets	9,181	7,244	7,887	8,093	8,270
Investments	59,686	82,227	86,227	111,227	116,227
Net fixed assets	46,186	61,171	56,328	68,946	75,706
CWIP	5,419	3,413	4,000	3,500	3,500
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(5,365)	(3,928)	(3,928)	(3,928)	(3,928)
Other assets	15,636	4,070	4,070	4,070	4,070
Total assets	171,047	183,565	205,184	236,133	250,472

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	39,869	37,739	34,984	41,321	46,522
Interest expenses	(86)	(220)	(220)	(220)	(220)
Non-cash adjustments	(6,913)	(7,783)	(6,570)	(8,392)	(9,667)
Changes in working capital	(24,871)	25,218	(8,966)	10,388	(11,561)
Other operating cash flows	(4,078)	2,301	0	0	0
Cash flow from operations	3,922	57,254	19,228	43,097	25,075
Capital expenditures	(7,895)	(21,159)	(2,587)	(19,500)	(15,000)
Change in investments	15,566	(22,540)	(4,000)	(25,000)	(5,000)
Other investing cash flows	6,913	7,783	6,570	8,392	9,667
Cash flow from investing	14,583	(35,916)	(18)	(36,108)	(10,333)
Equities issued/Others	57	44	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(86)	(220)	(220)	(220)	(220)
Dividends paid	(18,974)	(19,170)	(9,984)	(15,975)	(15,975)
Other financing cash flows	249	(1,437)	0	0	0
Cash flow from financing	(18,754)	(20,783)	(10,204)	(16,195)	(16,195)
Changes in cash and cash eq.	(249)	555	9,006	(9,206)	(1,453)
Closing cash and cash eq.	1,365	2,419	11,807	3,041	2,027

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	169.5	148.0	140.9	170.0	191.7
Adjusted EPS	169.5	148.0	140.9	170.0	191.7
Dividend per share	95.0	80.0	50.0	80.0	80.0
Book value per share	643.9	707.9	798.6	888.5	1,000.2

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	2.0	2.4	2.2	1.9	1.8
EV/EBITDA	13.9	17.3	18.0	15.1	13.6
Adjusted P/E	20.3	23.2	24.4	20.2	17.9
P/BV	5.3	4.9	4.3	3.9	3.4

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	68.8	64.6	74.8	74.8	74.8
Interest burden (PBT/EBIT)	98.0	116.7	99.4	99.5	99.6
EBIT margin (EBIT/Revenue)	14.9	13.6	12.3	13.1	13.4
Asset turnover (Revenue/Avg TA)	270.7	211.8	203.1	205.7	202.6
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	27.5	21.9	18.7	20.1	20.3

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	4.4	(14.3)	6.8	13.4	10.2
EBITDA	(6.6)	(19.7)	(3.7)	17.0	12.1
Adjusted EPS	(8.5)	(12.7)	(4.8)	20.6	12.8
Profitability & Return ratios (%)					
EBITDA margin	14.7	13.7	12.4	12.8	13.0
EBIT margin	14.9	13.6	12.3	13.1	13.4
Adjusted profit margin	10.1	10.3	9.1	9.7	10.0
Adjusted ROAE	26.3	20.9	17.6	19.1	19.2
ROCE	27.0	22.9	18.7	20.1	20.3
Working capital days (days)					
Receivables	24	28	26	29	28
Inventory	10	14	13	13	13
Payables	54	60	56	60	57
Ratios (x)					
Gross asset turnover	0.3	0.5	0.5	0.5	0.5
Current ratio	1.2	0.9	1.3	0.9	1.1
Net interest coverage ratio	(583.6)	(177.9)	(172.0)	(207.2)	(233.6)
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

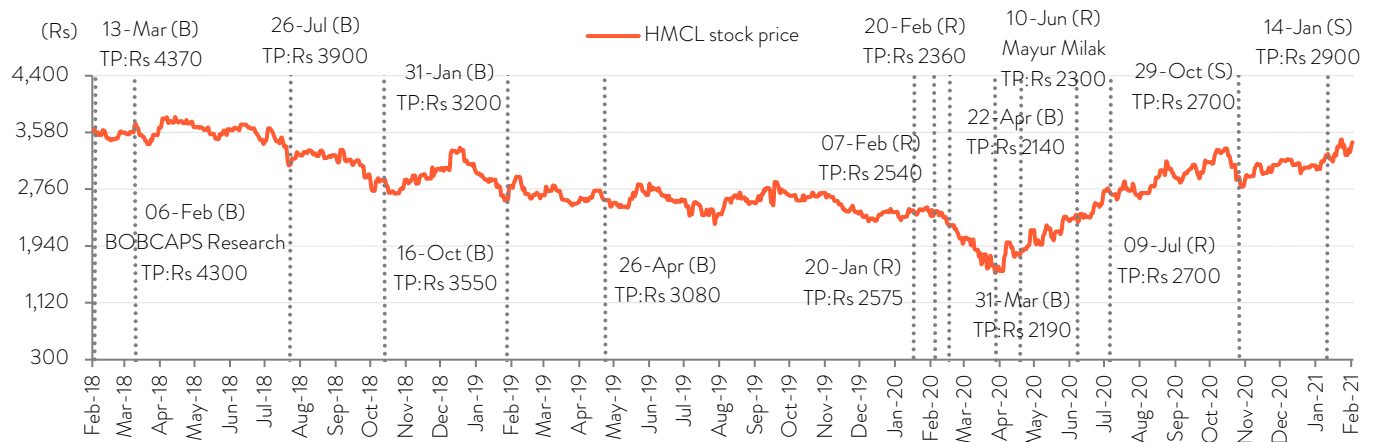
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): HERO MOTOCORP (HMCL IN)



B – Buy, A – Add, R – Reduce, S – Sell

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