

HOLD

TP: Rs 2,900 | ▲ 4%

HERO MOTOCORP

| Automobiles

| 13 August 2021

Lacklustre quarter

- Q1 revenue fell 37% QoQ on reduced volumes and ASP. High RM cost and lower operating efficiency further dampened PAT
- RM headwinds to continue in the near term; domestic volumes forecast to grow just 8% in FY22 on high dealer inventory
- Mar'22 TP maintained at Rs 2,900; retain HOLD

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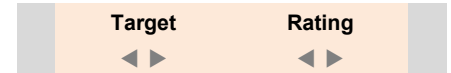
Higher RM cost dents profitability: HMCL's Q1FY22 sale volumes declined 35% QoQ to 10mn units impacted by the second Covid wave coupled with ASP decline. This resulted in a 37% QoQ decrease in revenue to Rs 54.9bn (Rs 57.3bn est.). Gross margin contracted 210bps QoQ while higher staff cost and a lack of operating leverage further weakened EBITDA margin, which slipped 455bps QoQ to 9.4% (12.6% est.). Adj. PAT declined 58% QoQ to Rs 3.7bn.

Above-normal inventory to subdue volumes: With inventories above normal, the sustainability of production will hinge on a pickup in retail sales. We expect flattish domestic sale volumes YoY in Q2FY22 despite pent-up demand and believe the wholesale segment would lag retail owing to the higher dealer inventory.

RM cost headwinds to continue: We remain cautious on profitability as the sharp inflation in key inputs is estimated to deplete near-term gross margin by >50bps (over FY21 levels), assuming the company takes a 6% hike in vehicle prices in FY22. Raw material costs are likely to remain elevated and will continue to impact margins and profitability in the near term.

Maintain HOLD: We maintain our FY22/FY23 revenue and earnings estimates and introduce forecasts for FY24, projecting a revenue/EBITDA/adj. PAT CAGR of +12%/+12%/+14% over FY21-FY24 with EBITDA margin at ~13%. Our FY22/FY23 EPS estimates are at Rs 170/Rs 192, 6-8% lower than consensus as we bake in softer gross margin assumptions. We continue to value HMCL at 15x FY23E EPS – in line with its 10-year average – for a Mar'22 TP of Rs 2,900. Reiterate HOLD.

Key changes



Ticker/Price	HMCL IN/Rs 2,783
Market cap	US\$ 7.5bn
Free float	65%
3M ADV	US\$ 26.3mn
52wk high/low	Rs 3,629/Rs 2,740
Promoter/FPI/DII	35%/32%/19%

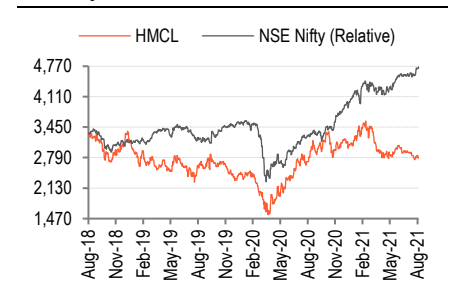
Source: NSE | Price as of 12 Aug 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	308,006	352,605	388,430
EBITDA (Rs mn)	40,191	45,268	50,306
Adj. net profit (Rs mn)	29,641	33,981	38,363
Adj. EPS (Rs)	148.4	170.2	192.1
Consensus EPS (Rs)	148.4	180.1	208.0
Adj. ROAE (%)	19.5	20.0	19.9
Adj. P/E (x)	18.7	16.4	14.5
EV/EBITDA (x)	13.8	12.2	11.0
Adj. EPS growth (%)	0.3	14.6	12.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	FY21	FY20	YoY (%)
Volume	1,024,489	563,426	81.8	1,568,313	(34.7)	5,791,696	6,409,719	(9.6)
Avg. Realisation per Vehicle (Rs)	53,559	52,741	1.6	55,384	(3.3)	53,181	44,988	18.2
Net Revenues	54,871	29,715	84.7	86,860	(36.8)	308,006	288,361	6.8
Total Income (A)	54,871	29,715	84.7	86,860	(36.8)	308,006	288,361	6.8
Operating Expenses:								
Raw materials consumed	39,796	20,939	90.1	61,173	(34.9)	217,623	196,974	10.5
Employee Expenses	4,357	3,824	13.9	4,884	(10.8)	18,987	18,417	3.1
Other Expenses	5,570	3,872	43.8	8,691	(35.9)	31,203	33,390	(6.5)
Total Expenditure (B)	49,722	28,635	73.6	74,748	(33.5)	267,814	248,781	7.7
EBITDA (A-B)	5,148	1,081	376.5	12,112	(57.5)	40,192	39,580	1.5
Other Income	1,386	1,485	(6.6)	874	58.6	5,799	7,783	(25.5)
Depreciation	1,630	1,708	(4.6)	1,632	(0.1)	6,770	8,180	(17.2)
EBIT	4,904	858	471.9	11,353	(56.8)	39,221	39,183	0.1
Finance Costs	61	63	(2.7)	63	(3.2)	218	220	(0.8)
PBT before excep items	4,844	795	509.3	11,290	(57.1)	39,003	38,963	0.1
PBT after excep items	4,844	795	509.3	11,290	(57.1)	39,003	45,736	(14.7)
Tax expense	1,189	182	554.1	2,642	(55.0)	9,362	9,404	(0.5)
Reported PAT	3,654	613	496.1	8,649	(57.7)	29,641	36,332	(18.4)
Adjusted PAT	3,654	613	496.1	8,649	(57.7)	29,641	29,559	0.3
Adj EPS (Rs)	18.3	3.1	496.1	43.3	(57.7)	148	148	0.3

Source: Company, BOBCAPS Research

Fig 2 – Key parameters

(%)	Q1FY22	Q1FY21	YoY (bps)	Q4FY21	QoQ (bps)	FY21	FY20	YoY (bps)
Gross margin	27.5	29.5	(206)	30.1	(210)	29.3	31.7	(235)
EBITDA margin	9.4	3.6	575	14.2	(456)	13.0	13.7	(68)
EBIT margin	8.9	2.9	605	13.1	(413)	12.7	13.6	(85)
PBT margin	8.8	2.7	615	13.4	(417)	12.7	13.5	(85)
Tax rate	24.6	22.9	168	23.1	115	24.0	20.6	344
Adj PAT margin	6.7	2.1	460	10.6	(330)	9.6	10.3	(63)

Source: Company, BOBCAPS Research

Valuation methodology

We maintain our FY22/FY23 revenue and earnings estimates and introduce forecasts for FY24, projecting a revenue/EBITDA/adj. PAT CAGR of +12%/+12%/+14% over FY21-FY24 with EBITDA margin at ~13%. Our FY22/FY23 EPS estimates are at Rs 170/Rs 192, 6-8% lower than consensus as we bake in softer gross margin assumptions. We continue to value HMCL at 15x FY23E EPS – in line with its 10-year average – for a Mar'22 TP of Rs 2,900. Reiterate HOLD.

Fig 3 – Key assumptions

(Rs mn)	FY21	FY22E	FY23E	FY24E
Volumes	5,791,539	6,254,862	6,755,251	7,295,671
Revenues	308,006	352,605	388,430	427,895
EBITDA	40,191	45,268	50,306	55,891
OPM (%)	13.0	12.8	13.0	13.1
Adj. PAT	29,641	33,981	38,363	43,395
EPS (Rs)	148.4	170.2	192.1	217.3

Source: Company, BOBCAPS Research

Fig 4 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY21-23E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY22E	FY23E	FY22E	FY23E	
Bajaj Auto	BJAUT IN	SELL	3,200	15.7	174.7	190.1	20.0	21.4	17
TVS Motors	TVSL IN	SELL	480	12.5	12.9	16.9	14.1	14.4	24
Hero MotoCorp	HMCL IN	HOLD	2,900	12.3	170.2	192.1	20.0	19.9	15
Eicher Motors	EIM IN	SELL	2,200	20.7	66.1	87.0	16.8	19.1	24

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- 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.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ashok Leyland	AL IN	5.3	134	80	SELL
Bajaj Auto	BJAUT IN	14.7	3,769	3,200	SELL
Hero MotoCorp	HMCL IN	7.5	2,783	2,900	HOLD
Mahindra & Mahindra	MM IN	13.0	776	630	SELL
Maruti Suzuki	MSIL IN	28.5	7,012	8,000	HOLD
TVS Motor	TVSL IN	3.5	552	480	SELL
VST Tillers Tractors	VSTT IN	0.2	1,909	2,300	HOLD

Source: BOBCAPS Research, NSE | Price as of 12 Aug 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	288,361	308,006	352,605	388,430	427,895
EBITDA	39,580	40,191	45,268	50,306	55,891
Depreciation	8,180	6,769	7,248	7,836	8,306
EBIT	39,184	39,221	45,650	51,508	58,235
Net interest inc./(exp.)	(220)	(218)	(220)	(220)	(220)
Other inc./(exp.)	7,783	5,799	7,630	9,037	10,650
Exceptional items	6,774	0	0	0	0
EBT	45,737	39,003	45,430	51,288	58,015
Income taxes	9,404	9,362	11,448	12,924	14,620
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	36,333	29,641	33,981	38,363	43,395
Adjustments	(6,774)	0	0	0	0
Adjusted net profit	29,559	29,641	33,981	38,363	43,395

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	30,305	52,046	47,700	52,547	57,886
Other current liabilities	7,990	8,913	13,767	8,315	9,075
Provisions	2,689	3,328	3,328	3,328	3,328
Debt funds	0	0	0	0	0
Other liabilities	1,217	1,298	1,298	1,298	1,298
Equity capital	400	400	400	400	400
Reserves & surplus	140,965	151,586	169,592	191,980	219,401
Shareholders' fund	141,364	151,985	169,991	192,380	219,800
Total liab. and equities	183,565	217,570	236,085	257,868	291,387
Cash and cash eq.	2,419	2,572	1,751	2,188	2,521
Accounts receivables	16,031	24,268	27,856	30,298	32,092
Inventories	10,920	14,696	14,104	15,537	17,116
Other current assets	7,244	6,601	6,767	6,874	6,993
Investments	82,227	104,997	112,997	127,997	155,997
Net fixed assets	61,171	62,471	70,223	72,387	74,081
CWIP	3,413	1,779	2,200	2,400	2,400
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(3,928)	(4,041)	(4,041)	(4,041)	(4,041)
Other assets	4,070	4,229	4,229	4,229	4,229
Total assets	183,565	217,570	236,085	257,868	291,387

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	57,253	42,250	30,726	32,355	43,438
Capital expenditures	(21,159)	(6,435)	(15,421)	(10,200)	(10,000)
Change in investments	(22,540)	(22,770)	(8,000)	(15,000)	(28,000)
Other investing cash flows	7,783	5,799	7,630	9,037	10,650
Cash flow from investing	(35,916)	(23,407)	(15,792)	(16,163)	(27,350)
Equities issued/Others	44	0	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(220)	(218)	(220)	(220)	(220)
Dividends paid	(19,170)	(20,959)	(15,975)	(15,975)	(15,975)
Other financing cash flows	(1,437)	113	0	0	0
Cash flow from financing	(20,783)	(21,065)	(16,195)	(16,195)	(16,195)
Chg in cash & cash eq.	555	(2,221)	(1,261)	(3)	(107)
Closing cash & cash eq.	2,419	2,572	1,751	2,188	2,521

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	148.0	148.4	170.2	192.1	217.3
Adjusted EPS	148.0	148.4	170.2	192.1	217.3
Dividend per share	80.0	105.0	80.0	80.0	80.0
Book value per share	707.9	761.1	851.3	963.4	1,100.7

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	1.9	1.8	1.6	1.4	1.3
EV/EBITDA	14.0	13.8	12.2	11.0	9.9
Adjusted P/E	18.8	18.7	16.4	14.5	12.8
P/BV	3.9	3.7	3.3	2.9	2.5

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	64.6	76.0	74.8	74.8	74.8
Interest burden (PBT/EBIT)	116.7	99.4	99.5	99.6	99.6
EBIT margin (EBIT/Revenue)	13.6	12.7	12.9	13.3	13.6
Asset turnover (Rev./Avg TA)	211.8	208.2	217.3	212.9	206.3
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	21.9	20.2	21.1	21.2	21.1

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(14.3)	6.8	14.5	10.2	10.2
EBITDA	(19.7)	1.5	12.6	11.1	11.1
Adjusted EPS	(12.7)	0.3	14.6	12.9	13.1
Profitability & Return ratios (%)					
EBITDA margin	13.7	13.0	12.8	13.0	13.1
EBIT margin	13.6	12.7	12.9	13.3	13.6
Adjusted profit margin	10.3	9.6	9.6	9.9	10.1
Adjusted ROAE	20.9	19.5	20.0	19.9	19.7
ROCE	22.9	20.1	21.0	21.1	21.0

Working capital days (days)

	FY20A	FY21A	FY22E	FY23E	FY24E
Receivables	28	24	27	27	27
Inventory	14	15	15	14	14
Payables	60	69	73	66	66

Ratios (x)

	FY20A	FY21A	FY22E	FY23E	FY24E
Gross asset turnover	0.5	0.5	0.5	0.4	0.4
Current ratio	0.9	0.7	0.8	0.9	0.8
Net interest coverage ratio	(177.9)	(179.9)	(207.5)	(234.1)	(264.7)
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

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

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

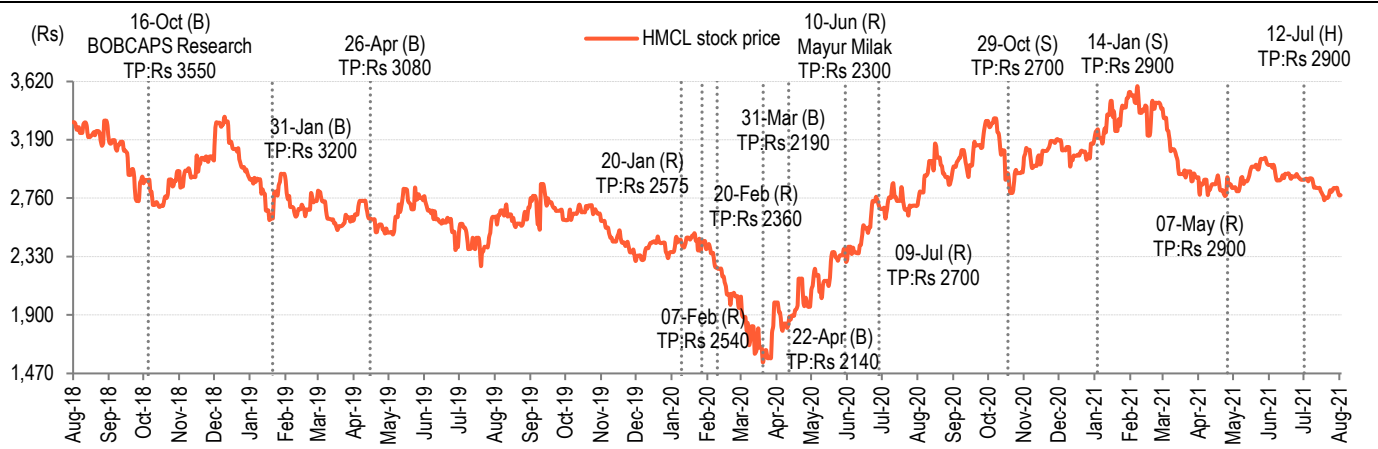
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): HERO MOTOCORP (HMCL IN)



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

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