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### Q4FY20 result review and reco change

## Automobiles

Target price: Rs2,268

### Earnings revision

(%)	FY21E	FY22E
Sales	↓ 4.4	↓ 2.2
EBITDA	↓ 7.7	↑ 1.0
EPS	↓ 8.8	↑ 0.8

### Target price revision

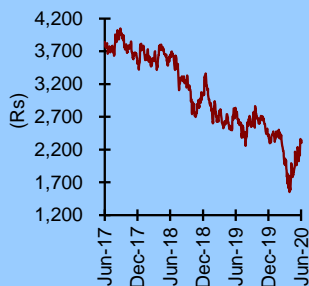
Rs2,268 from R2,251

### Shareholding pattern

	Sep '19	Dec '19	Mar '20
Promoters	34.6	34.6	34.6
Institutional investors	55.6	54.9	54.2
MFs and UTI	7.3	7.4	8.0
FIs/Banks	1.9	2.0	2.0
Insurance	8.3	8.4	8.3
FII	38.1	37.1	35.9
Others	9.8	10.5	11.2

Source: NSE

### Price chart



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INDIA

**ICICI Securities**

# Hero MotoCorp

**HOLD**

Downgrade from ADD

Rural recovery led revival priced in

**Rs2,386**

Hero MotoCorp (HMCL)'s Q4FY20 operating numbers were below consensus expectations, with EBITDA margin at 10.6% (down 298bps YoY). Topline declined ~21% to ~Rs62bn as volumes declined 25% due to Covid lockdown and BS-4 inventory clearance impact (I-Se est. ~Rs2bn). Our industry volume decline expectation of ~18-20% for FY21 remain unchanged, we believe demand recovery would be led by rural markets (superior cash flows via farm, MNREGA activities). Hence, the relative preference for rural-facing auto segments, 2Ws stays and HMCL's high rural exposure (>50% demand) tilts near term beneficiary scales in its favour. However, post ~50% rally since Mar'20 lows the valuations are mean reverting (~11x FY20 EV/EBITDA), thus limiting upside. We downgrade to HOLD.

Earnings call: 11:30 am IST, 10<sup>th</sup> June. Dial-in: +91 22 7115 8805

- Key highlights of the quarter:** Hero MotoCorp reported EBITDA margins of 10.6%, down 298bps (down 27bps YoY) as gross margins held firm. Gross margins were sustained by a) lower RM costs, b) favourable product mix, and c) LEAP programme benefits. Tax outgo declined 91% due to a) shift to new tax regime and b) realignment of excess provisioning due to lower FY20 profits. PAT declined 15% to Rs62bn.
- Chinese imports and Covid-19 crisis impact sales:** HMCL's business was impacted from lockdowns and import disruptions from China for Jan-Feb'20 for its BSVI parts supplies and then closure of all its facilities in Mar'20. As per Hero, revenues for Q4FY20 would have been Rs74bn and underlying EBITDA margin 13.5% if not for the Covid related impacts. The company also decided to absorb losses from the sudden nation-wide lockdown declared in the last week of March with an inventory loss of ~150k units prior to the lockdown (Delhi NCR: ~12k units). BS-VI products with better fuel efficiency and a price differential of Rs6-8k compared to BS-IV unit aided ASP rise of 5.6% to 46.7k/vehicle. Benefits from lower commodity basket prices to accrue in H2FY21 as production normalises.
- Downgrade to HOLD:** We believe HMCL has potential growth tailwinds in H2FY21 from a) rural recovery, b) downtrading in motorcycles. However, in case urban (*read high Covid impact*) customers seek increased personal transportation scooter segment could stand to gain, HMCL remains a weaker player in this category. We like the stock, however, the recent rally (~50%) has minimized our valuation comfort. We cut our EPS for FY21E/FY22E by -8.8%/0.8%, respectively, while maintaining our target multiple at 15x FY22E EPS. We downgrade the stock to **HOLD** from **ADD** with a revised target price of Rs2,268 (earlier: Rs2,251).

Market Cap	Rs477bn/US\$6.3bn	Year to Mar	FY19	FY20P	FY21E	FY22E
Reuters/Bloomberg	HRM.BO/HMCL IN	Revenue (Rs mn)	3,36,505	2,88,361	2,58,073	2,98,651
Shares Outstanding (mn)	199.7	Rec. Net Income (Rs mn)	33,849	29,559	21,908	30,198
52-week Range (Rs)	2863/1554	EPS (Rs)	169.5	148.0	109.7	151.2
Free Float (%)	65.4	% Chg YoY	(8.5)	(12.7)	(25.9)	37.8
FII (%)	35.9	P/E (x)	14.0	13.1	21.7	15.7
Daily Volume (US\$/000)	38,414	CEPS (Rs)	199.6	222.9	155.1	199.6
Absolute Return 3m (%)	22.0	EV/E (x)	8.8	10.7	13.1	9.6
Absolute Return 12m (%)	(10.1)	Dividend Yield (%)	3.7	3.8	3.2	4.2
Sensex Return 3m (%)	(4.4)	RoCE (%)	27.7	22.2	15.1	19.7
Sensex Return 12m (%)	(13.3)	RoE (%)	27.5	21.9	15.1	19.7

Please refer to important disclosures at the end of this report

**Table 1: Q4FY20 result review***(Rs mn, year ending March 31)*

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Volume (Units)	13,34,511	17,81,246	(25.1)	15,40,868	(13.4)
<b>Net realisation</b>	<b>46,747</b>	<b>44,267</b>	<b>5.6</b>	<b>45,408</b>	<b>2.9</b>
<b>Total Operating Income</b>	<b>62,384</b>	<b>78,850</b>	<b>(20.9)</b>	<b>69,967</b>	<b>(10.8)</b>
Raw Material Costs	43,200	54,385	(20.6)	46,598	(7.3)
Employee Costs	4,354	4,473	(2.7)	4,697	(7.3)
Other Expenses	8,231	9,298	(11.5)	8,282	(0.6)
<b>Total operating expenses</b>	<b>55,785</b>	<b>68,156</b>	<b>(18.2)</b>	<b>59,578</b>	<b>(6.4)</b>
<b>Reported EBITDA</b>	<b>6,599</b>	<b>10,693</b>	<b>(38.3)</b>	<b>10,390</b>	<b>(36.5)</b>
<b>EBITDA Margin (%)</b>	<b>10.6</b>	<b>13.6</b>	<b>-298 bps</b>	<b>14.8</b>	<b>-427 bps</b>
Depreciation & Amortisation	1,747	1,502	16.3	2,037	(14.2)
Other income	1,695	1,642	3.2	1,822	(7.0)
Interest Expenses	41	22	85.4	59	(31.4)
Exceptional item	0	0	NC	0	NC
PBT	6,506	10,811	(39.8)	10,115	(35.7)
Tax	299	3,508	(91.5)	1,311	(77.2)
<b>PAT</b>	<b>6,207</b>	<b>7,303</b>	<b>(15.0)</b>	<b>8,804</b>	<b>(29.5)</b>

Source: Company data, I-Sec research

**Table 2: Earnings revision**

	FY21E			FY22E		
	Previous	New	Chg (%)	Previous	New	Chg (%)
Sales	2,71,484	2,58,073	(4.9)	3,07,209	2,98,651	(2.8)
EBITDA	34,618	31,951	(7.7)	42,234	42,636	1.0
PAT	24,034	21,908	(8.8)	29,970	30,198	0.8
EPS (Rs)	120.3	109.7	(8.8)	150.0	151.2	0.8

Source: I-Sec research

**Table 3: Key assumptions for HMCL***(Rs mn)*

	FY18	FY19	FY20	FY21E	FY22E
Motorcycle volumes	66,77,207	70,79,193	59,90,349	49,49,266	56,39,348
Scooter volumes	9,09,986	7,39,958	4,19,370	3,14,528	3,54,020
Realisation/unit	42,480	43,036	44,988	49,028	49,830
EBITDA/unit	6,959	6,305	6,175	6,070	7,114

Source: Company data, I-Sec research

## Valuation methodology and key risks

We believe HMCL has potential growth tailwinds in H2FY21 from a) rural recovery, b) downtrading in motorcycles. However, in case urban (read high Covid impact) customers seek increased personal transportation scooter segment could stand to gain, HMCL remains a weaker player in this category. We like the stock, however, the recent rally (~50%) has minimized our valuation comfort. We cut our EPS for FY21E/FY22E by -8.8%/0.8%, respectively, while maintaining our target multiple at 15x FY22E EPS. We downgrade the stock to **HOLD** from **ADD** with a revised target price of Rs2,268 (earlier: Rs2,251)..

## Financial summary (standalone)

Table 4: Profit and loss statement

(Rs mn, year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Operating Income (Sales)</b>	<b>3,36,505</b>	<b>2,88,361</b>	<b>2,58,073</b>	<b>2,98,651</b>
Of Which 2W	295907	248620	219689	252214
Of Which Spares	28360	28360	25524	31905
<b>Operating Expenses</b>	<b>2,87,205</b>	<b>2,48,781</b>	<b>2,26,122</b>	<b>2,56,015</b>
<b>EBITDA</b>	<b>49,301</b>	<b>39,580</b>	<b>31,951</b>	<b>42,636</b>
% margins	14.7	13.7	12.4	14.3
Depreciation & Amortisation	6,020	8,180	9,069	9,667
Gross Interest	86	220	209	205
Other Income	6,913	7,783	6,616	7,608
<b>Recurring PBT</b>	<b>50,107</b>	<b>38,963</b>	<b>29,289</b>	<b>40,372</b>
Add: Extraordinaries	-	6,774	-	-
Less: Taxes	16,259	9,404	7,381	10,174
<b>Net Income (Reported)</b>	<b>33,849</b>	<b>36,333</b>	<b>21,908</b>	<b>30,198</b>
<b>Recurring Net Income</b>	<b>33,849</b>	<b>29,559</b>	<b>21,908</b>	<b>30,198</b>

Source: Company data, I-Sec research

Table 5: Balance sheet

(Rs mn, year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Assets</b>				
Total Current Assets	50,085	36,614	34,831	40,711
of which cash & cash eqv.	1,365	2,419	3,212	4,271
Total Current Liabilities & Provisions	42,476	42,201	37,020	42,615
<b>Net Current Assets</b>	<b>7,609</b>	<b>(5,587)</b>	<b>(2,189)</b>	<b>(1,904)</b>
<b>Investments</b>	<b>59,686</b>	<b>82,227</b>	<b>85,727</b>	<b>95,227</b>
of which				
Strategic/Group	28,015	35,282	33,782	35,282
Other Marketable	31,671	46,945	51,945	59,945
<b>Net Fixed Assets</b>	<b>51,604</b>	<b>64,588</b>	<b>64,519</b>	<b>64,852</b>
Of Which Royalty Intangible	-	-	-	-
<b>Total Assets</b>	<b>1,25,543</b>	<b>1,42,196</b>	<b>1,49,123</b>	<b>1,59,346</b>
<b>Liabilities</b>				
Long term Liabilities	-	-	-	-
Deferred Tax Liability	(3,028)	827	827	827
Deferred Payment Credits*	-	-	-	-
Equity Share Capital	400	400	400	400
Face Value per share (Rs)	2	2	2	2
Reserves & Surplus*	1,28,171	1,40,970	1,47,896	1,58,120
<b>Net Worth</b>	<b>1,28,570</b>	<b>1,41,369</b>	<b>1,48,296</b>	<b>1,58,519</b>
<b>Total Liabilities</b>	<b>1,25,543</b>	<b>1,42,196</b>	<b>1,49,123</b>	<b>1,59,346</b>

Source: Company data, I-Sec research

Table 6: Quarterly trend

(Rs mn, year ending March 31)

	Jun-19	Sep-19	Dec-19	Mar-20
Net sales	80,303	75,707	69,967	62,384
% growth (YoY)				
EBITDA	11,580	11,011	10,390	6,599
Margin (%)	14.4	14.5	14.8	10.6
Other income	2,188	2,078	1,822	1,695
Add: Extraordinaries	7,375	(601)	-	-
<b>Net profit</b>	<b>12,573</b>	<b>8,748</b>	<b>8,804</b>	<b>6,207</b>

Source: Company data, I-Sec research

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Operating Cashflow</b>	<b>27,898</b>	<b>35,953</b>	<b>24,005</b>	<b>32,727</b>
Working Capital Changes	(18,083)	9,114	(2,622)	804
Capital Commitments	(15,847)	(21,431)	(7,500)	(11,500)
<b>Free Cashflow</b>	<b>(6,032)</b>	<b>23,637</b>	<b>13,883</b>	<b>22,031</b>
<b>Cashflow from Investing Activities</b>	<b>28,950</b>	<b>1,178</b>	<b>1,892</b>	<b>(997)</b>
Issue of Share Capital	0	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	-	-	-	-
Dividend paid	(20,333)	(21,034)	(14,981)	(19,975)
<b>Extraordinary Items</b>	<b>-</b>	<b>6,774</b>	<b>-</b>	<b>-</b>
<b>Chg. in Cash &amp; Bank balance</b>	<b>(49)</b>	<b>1,055</b>	<b>794</b>	<b>1,059</b>

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY19	FY20P	FY21E	FY22E
<b>Per Share Data (Rs)</b>				
EPS(Basic Recurring)	169.5	148.0	109.7	151.2
EPS(Basic)	169.5	181.9	109.7	151.2
Recurring Cash EPS	199.6	222.9	155.1	199.6
Dividend per share (DPS)	87.0	90	75	100
Book Value per share (BV)	643.8	707.9	742.6	793.8
<b>Growth Ratios (%)</b>				
Operating Income	4.4	(14.3)	(10.5)	15.7
EBITDA	(6.6)	(19.7)	(19.3)	33.4
Recurring Net Income	(8.5)	(12.7)	(25.9)	37.8
Diluted Recurring EPS	(8.5)	(12.7)	(25.9)	37.8
Diluted Recurring CEPS	(6.3)	11.6	(30.4)	28.7
<b>Valuation Ratios (x)</b>				
P/E	14.0	13.1	21.7	15.7
P/CEPS	11.9	10.7	15.3	11.9
P/BV	3.7	3.4	3.2	3.0
EV / EBITDA	8.8	10.7	13.1	9.6
EV / Operating Income	1.3	1.5	1.6	1.4
EV / Operating FCF	44.1	9.4	19.5	12.2
<b>Operating Ratios</b>				
Raw Material/Sales (%)	69.3	68.3	69.8	68.5
SG&A/Sales (%)	5.9	6.6	6.3	6.2
Other Income / PBT (%)	13.8	20.0	22.6	18.8
Effective Tax Rate (%)	32.4	24.1	25.2	25.2
NWC / Total Assets (%)	(25.5)	(41.1)	(40.6)	(43.8)
Inventory Turnover (days)	24.8	18.3	18.3	20.5
Receivables (days)	23.5	28.0	22.5	20.3
Payables (days)	55.5	63.8	63.4	56.7
D/E Ratio (x)	(2.4)	0.6	0.6	0.5
<b>Return/Profitability Ratios (%)</b>				
Recurring Net Income Margins	10.1	10.3	8.5	10.1
RoCE	27.7	22.2	15.1	19.7
RoNW	27.5	21.9	15.1	19.7
Dividend Payout Ratio	60.1	57.9	68.4	66.1
Dividend Yield	3.7	3.8	3.2	4.2
EBITDA Margins	14.7	13.7	12.4	14.3

Source: Company data, I-Sec research

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