

# Hero MotoCorp

<b>BSE SENSEX</b>	<b>S&amp;P CNX</b>
37,556	11,361

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## Stock Info

Bloomberg	HMCL IN
Equity Shares (m)	200
M.Cap.(INRb)/(USD\$b)	648.3 / 9.4
52-Week Range (INR)	4200 / 3037
1, 6, 12 Rel. Per (%)	-12/-18/-32
12M Avg Val (INR M)	1346
Free float (%)	65.4

## Financials Snapshot (INR b)

Y/E Mar	2018	2019E	2020E
Net Sales	322.3	362.1	398.0
EBITDA	52.8	57.8	63.9
PAT	37.0	38.6	43.8
EPS (INR)	185.1	193.4	219.0
Gr. (%)	9.5	4.5	13.2
BV/Sh (INR)	589.3	656.2	735.0
RoE (%)	33.8	31.1	31.5
RoCE (%)	32.5	29.9	30.4
P/E (x)	17.5	16.8	14.8
P/BV (x)	5.5	4.9	4.4

## Shareholding pattern (%)

As On	Jun-18	Mar-18	Jun-17
Promoter	34.6	34.6	34.6
DII	14.4	12.0	11.5
FII	39.6	41.9	42.9
Others	11.4	11.4	10.9

FII Includes depository receipts

**CMP: INR3,246 TP: INR3,446(+6%)**

**Neutral**

## Compete on product/brand and not react on pricing

**Focus on consolidating lead in commuter segment, filling gaps elsewhere**

We met Mr Niranjan Gupta (CFO) and Mr Sanjay Bhan (Head – Sales) of Hero MotoCorp (HMCL) to get an update on (a) competitive intensity in the Commuter segment, (b) product positioning for upcoming launches in the Scooter 125cc and Premium motorcycle segments and (c) risk to profitability from competition. While management sees a limited impact from the aggressive pricing strategy of a competitor, it is excited about the upcoming launches in the white spaces (Scooters 125cc and Premium motorcycle) of its product portfolio. Key highlights:

### Not to react to aggressive pricing, rather focus on product/brand

- HMCL does not plan to react to BJAUT's aggressive pricing for CT100 in the Economy segment. The company believes that differential pricing has always existed in 2Ws, and in none of the categories, cheaper products are market leaders.
- Its strategic focus would instead be on brand/product, which would include segment-specific marketing activities and product actions.
- Like BJUAT, HMCL believes that aggressive pricing could be driving expansion of the market as it makes products affordable. This is also reflected in HMCL's Economy segment volumes, which grew ~23% YoY (+4% QoQ) in 1QFY19, but the company still lost market share by ~170bp YoY (-770bp QoQ).
- It also believes that such aggressive price cuts will impact the brand, as resale value for existing customers will also decline substantially. Given very high relevance of total cost of ownership, such aggressive price cuts might be detrimental over the medium/long term.
- Lastly, it does not see customers downtrading from Splendor/Passion to CT100 as purchase decisions in these segments are also aspirational in nature.

### Consolidate lead in Commuter segment, fill white spaces...

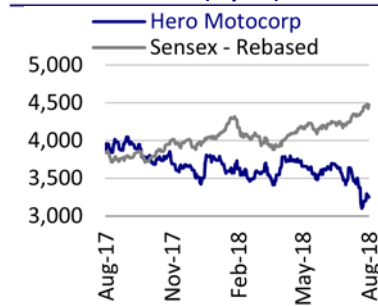
- HMCL is focused on consolidating its lead in the Economy, Executive 100 and 125cc segments, but continues strengthening its product portfolio with newer launches.
- It sees white spaces in 125cc Scooters and Premium segments, which will be filled ahead of the upcoming festive season. It would be launching Xtreme 200R motorcycle and two 125cc scooters.
- The market share recovery in Scooters and Premium motorcycles will, thus, help HMCL to improve its overall market share in domestic 2Ws.

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**Investors are advised to refer through important disclosures made at the last page of the Research Report.**

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**Stock Performance (1-year)****...with launch of two 125cc scooters and a 200cc motorcycle over next few months**

- There has been a clear trend of upward mobility in Scooters over the last five months, as visible in over 60% growth in 125cc scooters (~20% of scooter segment) and several new launches in this segment. This has resulted in HMCL's overall market share in scooters contracting by 240bp YoY (-340bp QoQ) in 1QFY19.
- It believes that the 125cc segment is still in a nascent stage, with clear leadership yet to be established. Also, customers' willingness to experiment is high, throwing up opportunities for new entrants like HMCL. Its product strategy is to offer evolution over the existing 100cc scooters by coming up with high-performance products.
- In the Premium motorcycle segment, it will be launching Hero Xtreme 200R, which provides customer with a much higher CC product with ABS technology at a slightly premium price. It is targeting to provide an option for upgrade for existing 160cc-180cc customers. It offers better performance parameters than most competing products. This product would be launched through selective dealers.

**Access to low-cost finance to further drive penetration, particularly in rural areas**

- HMCL sees headroom for further increase in penetration from current 10.2% of population (v/s 16.6% to 29% in countries like Malaysia, Indonesia and Thailand), driven particularly by high scope in rural markets (where penetration is 4-5%).
- 2W finance penetration is ~36% of total volumes. However, in rural markets, it would be ~20%. It sees substantial scope to improve (a) access to finance and (b) cost of finance. With the government's focus on digitalization and proliferation of NBFCs, both access and cost of finance will only improve, driving penetration in rural markets.
- For FY19, it maintains guidance of strong double-digit growth for the industry, driven by a third consecutive year of normal monsoon and higher MSPs.

**Maintains 14-16% EBITDA margin target with stable marketing spend**

- HMCL has maintained its EBITDA margin target of 14-16% based on its current product portfolio.
- It expects cost pressures to be offset by (a) ramp-up at Halol and upcoming AP plant, (b) cost-cutting initiatives and (c) operating leverage.
- Contrary to the general perception, marketing spends (including discounts) have not changed much (as % of sales) as it has been reallocating its resources in areas of priority.

**Valuation view**

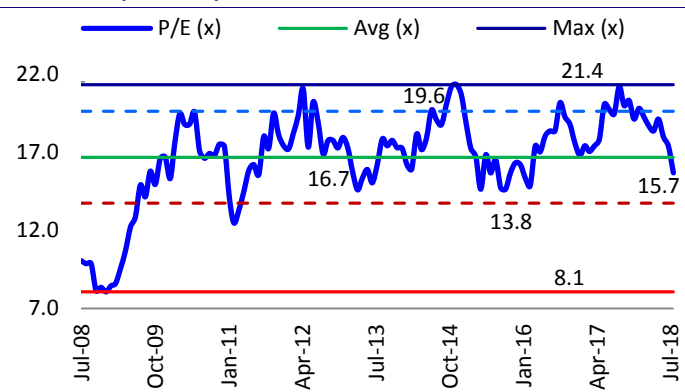
- We believe that concerns around pricing competition are overdone and see limited scope for further market share loss for HMCL due to the strength of brand equity of HF Deluxe and superior reach of HMCL.
- Valuations at 16.8x/14.8x FY19/20E EPS are attractive (considering medium-term volume momentum) but fairly capture the long-term growth prospects.
- We maintain **Neutral** with a TP of INR3,442 (15x Mar'20E EPS + INR157 per share of Hero FinCorp post 20% hold-co discount).

## Exhibit 1: Comparative Valuation

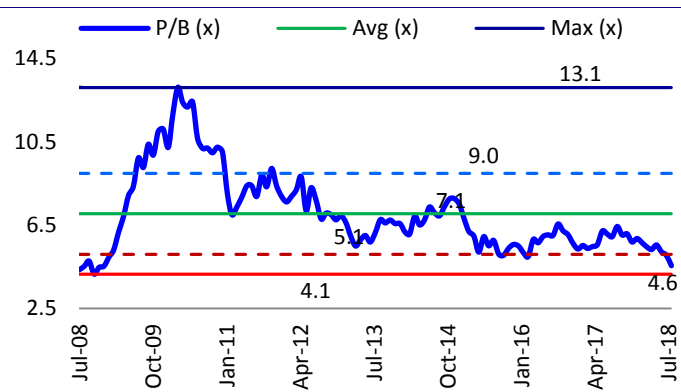
	CMP (INR)*	Rating	TP (INR)	P/E (x)		EV/EBITDA (x)		RoE (%)		Div Yield (%)		EPS CAGR (%)
				FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	
<b>Auto OEM's</b>												
Bajaj Auto	2,639	Buy	3,223	15.5	13.4	10.1	8.3	24.4	25.3	2.7	3.0	14.2
<b>Hero MotoCorp</b>	<b>3,112</b>	<b>Neutral</b>	<b>3,442</b>	<b>16.1</b>	<b>14.2</b>	<b>9.3</b>	<b>8.3</b>	<b>31.1</b>	<b>31.5</b>	<b>3.4</b>	<b>3.7</b>	<b>8.8</b>
TVS Motor	541	Neutral	572	30.6	21.1	17.9	13.0	26.3	30.8	0.7	0.9	35.7
M&M	909	Buy	1,063	18.0	16.5	14.5	13.0	15.1	15.0	1.1	1.1	16.0
Maruti Suzuki	9,758	Buy	10,455	28.9	22.7	17.9	14.4	20.8	22.7	1.0	1.3	26.9
Tata Motors	257	Buy	459	6.4	5.7	2.4	1.8	13.3	13.0	0.1	0.1	40.1
Ashok Leyland	110	Buy	149	16.6	12.7	8.1	5.4	25.1	27.7	2.0	2.3	26.9
Eicher Motors	27,346	Buy	34,264	27.7	21.2	22.4	18.3	33.2	33.2	0.6	0.7	27.0
Escorts	886	Neutral	973	17.5	13.7	14.2	10.9	18.7	20.3	0.6	0.6	28.2
<b>Auto Ancillaries</b>												
Bharat Forge	619	Buy	754	25.9	20.5	14.7	12.3	22.0	23.4	0.8	1.0	30.6
Exide Industries	274	Buy	300	26.2	21.5	15.3	12.8	14.7	15.9	1.0	1.2	24.5
Amara Raja Batteries	789	Buy	945	24.8	20.9	12.8	10.6	17.2	17.7	0.6	0.7	17.0
BOSCH	19,022	Neutral	19,017	32.8	27.0	20.9	17.0	16.8	18.4	1.0	1.3	22.4
Endurance Tech	1,329	Buy	1,483	36.3	26.9	16.9	13.3	21.7	24.7	0.5	0.9	30.4
Motherson Sumi	300	Buy	414	26.2	18.1	9.5	6.6	23.7	28.5	1.0	1.5	42.4
CEAT	1,357	Buy	1,588	17.8	13.7	10.3	7.9	11.2	13.2	0.6	0.8	24.6

Source: Company, MOSL

## Exhibit 2: P/E and P/B band



Source: MOSL



Source: MOSL

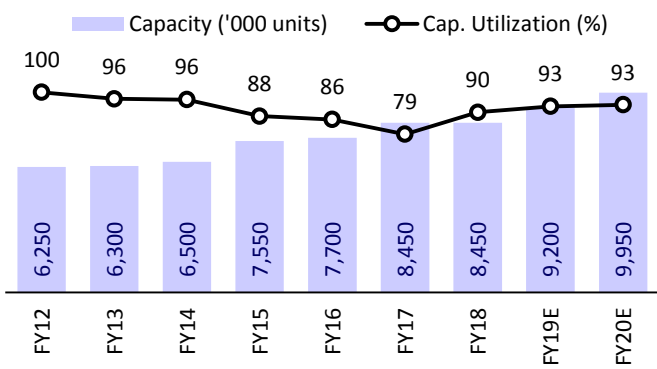
## Exhibit 3: Snapshot of revenue model

000 units	FY13	FY14	FY15	FY16	FY17	FY18	FY19E	FY20E
Total M/Cycles	5,501	5,538	5,800	5,736	5,834	6,677	7,484	8,097
Growth (%)	-4.8	0.7	4.7	-1.1	1.7	14.4	12.1	8.2
% of total volumes	90.5	88.7	87.5	86.5	87.5	88.0	87.7	87.1
Total Scooters	574	708	832	896	830	910	1,046	1,203
Growth (%)	26.1	23.2	1758.1	772.7	-742.1	966.5	15.0	15.0
% of total volumes	9.5	11.3	12.5	13.5	12.5	12.0	12.3	12.9
<b>Total volumes</b>	<b>6,076</b>	<b>6,246</b>	<b>6,632</b>	<b>6,632</b>	<b>6,664</b>	<b>7,587</b>	<b>8,530</b>	<b>9,300</b>
Growth (%)	-2.6	2.8	6.2	0.0	0.5	13.9	12.4	9.0
- of which Exports	0	113	120	133	141	178	205	236
% of total volumes	0.0	2.0	2.0	2.2	2.3	2.6	2.6	2.8
Avg. Net Realn (INR/unit)	38,816	40,226	41,242	42,220	41,953	41,332	41,663	41,996
Growth (%)	3.6	3.6	2.5	2.4	-0.6	-1.6	0.8	0.8
<b>Net Revenues (INR b)</b>	<b>236</b>	<b>251</b>	<b>274</b>	<b>280</b>	<b>280</b>	<b>314</b>	<b>355</b>	<b>391</b>
Growth (%)	0.9	6.5	8.9	2.4	-0.2	12.1	13.3	9.9

Source: Company, MOSL

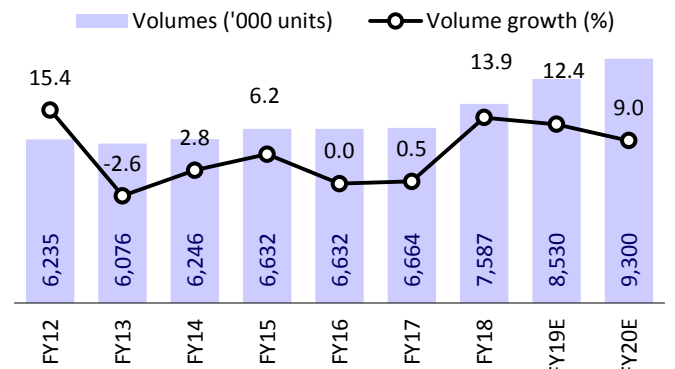
**Story in charts: EPS CAGR of 9% over FY18-20E**

**Exhibit 4: Adding capacity ahead of growth**



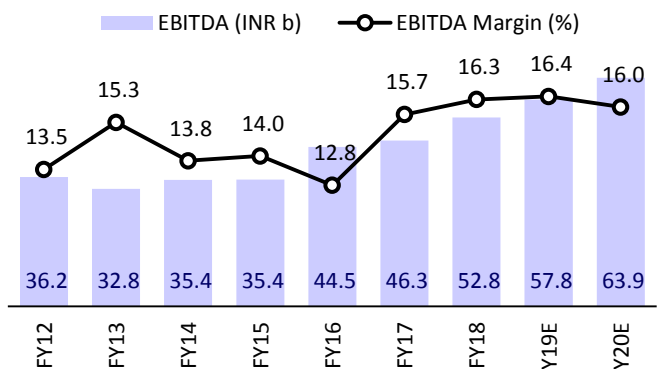
Source: Company, MOSL

**Exhibit 5: Volume sustainability led by rural recovery**



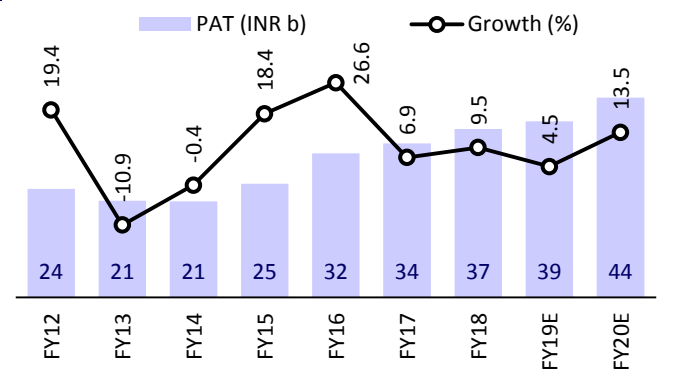
Source: Company, MOSL

**Exhibit 6: EBITDA margins to remain above 16%**



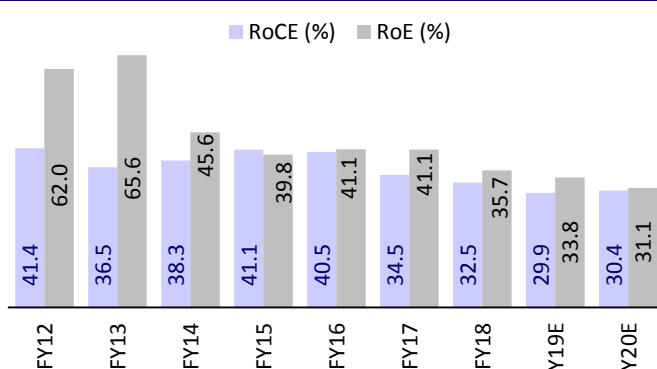
Source: Company, MOSL

**Exhibit 7: PAT to rise on robust growth**



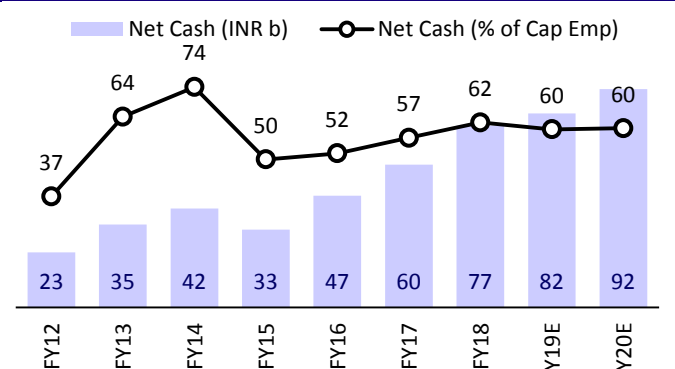
Source: Company, MOSL

**Exhibit 8: Return ratios to moderate, but are still healthy...**



Source: Company, MOSL

**Exhibit 9: ...as cash levels rise further**



Source: Company, MOSL

## Financials and Valuations

Income Statement							(INR Million)	
Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
<b>Net Sales</b>	<b>237,681</b>	<b>252,755</b>	<b>275,853</b>	<b>284,427</b>	<b>285,005</b>	<b>322,305</b>	<b>362,147</b>	<b>397,996</b>
Change (%)	0.8	6.3	9.1	3.1	0.2	13.1	12.4	9.9
<b>EBITDA</b>	<b>32,845</b>	<b>35,401</b>	<b>35,422</b>	<b>44,550</b>	<b>46,348</b>	<b>52,802</b>	<b>57,804</b>	<b>63,919</b>
EBITDA Margin (%)	13.8	14.0	12.8	15.7	16.3	16.4	16.0	16.1
Depreciation	11,418	11,074	5,400	4,376	4,927	5,556	6,025	6,481
<b>EBIT</b>	<b>21,427</b>	<b>24,327</b>	<b>30,022</b>	<b>40,174</b>	<b>41,421</b>	<b>47,246</b>	<b>51,779</b>	<b>57,439</b>
Interest	119	118	111	49	61	63	50	50
Other Income	3,984	4,464	4,927	4,224	5,224	5,258	5,075	6,150
Extraordinary items	0	0	-1,550	0	0	0	0	0
<b>PBT</b>	<b>25,292</b>	<b>28,673</b>	<b>33,288</b>	<b>44,349</b>	<b>46,585</b>	<b>52,442</b>	<b>56,804</b>	<b>63,539</b>
Tax	4,110	7,582	9,432	12,747	12,813	15,468	18,177	19,697
Tax Rate (%)	16.3	26.4	28.3	28.7	27.5	29.5	32.0	31.0
Min. Int. & Assoc. Share	0	0	0	0	0	0	0	0
<b>Reported PAT</b>	<b>21,182</b>	<b>21,091</b>	<b>23,856</b>	<b>31,602</b>	<b>33,771</b>	<b>36,974</b>	<b>38,626</b>	<b>43,842</b>
<b>Adjusted PAT</b>	<b>21,182</b>	<b>21,091</b>	<b>24,968</b>	<b>31,602</b>	<b>33,771</b>	<b>36,974</b>	<b>38,626</b>	<b>43,842</b>
Change (%)	-10.9	-0.4	18.4	26.6	6.9	9.5	4.5	13.5

Balance Sheet							(INR Million)	
Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Share Capital	399	399	399	399	399	399	399	400
Reserves	49,663	55,599	65,014	87,945	100,714	117,289	130,649	146,748
<b>Net Worth</b>	<b>50,062</b>	<b>55,999</b>	<b>65,413</b>	<b>88,344</b>	<b>101,113</b>	<b>117,689</b>	<b>131,048</b>	<b>147,148</b>
Debt	3,022	245	313	0	0	0	0	0
Deferred Tax	1,324	0	0	2,225	4,143	5,117	5,117	5,117
<b>Total Capital Employed</b>	<b>54,408</b>	<b>56,243</b>	<b>65,727</b>	<b>90,569</b>	<b>105,256</b>	<b>122,805</b>	<b>136,165</b>	<b>152,265</b>
Gross Fixed Assets	67,355	69,089	81,140	91,263	103,772	111,344	116,028	128,528
Less: Acc Depreciation	36,645	46,657	52,013	55,420	59,816	64,799	70,824	77,305
<b>Net Fixed Assets</b>	<b>30,710</b>	<b>22,433</b>	<b>29,127</b>	<b>35,844</b>	<b>43,956</b>	<b>46,545</b>	<b>45,204</b>	<b>51,223</b>
Capital WIP	621	8,541	2,883	6,054	4,651	3,184	11,000	11,000
Investments	36,238	40,888	31,541	45,810	58,899	75,252	75,252	75,252
<b>Current Assets</b>	<b>28,848</b>	<b>29,112</b>	<b>41,666</b>	<b>38,021</b>	<b>39,438</b>	<b>42,407</b>	<b>55,275</b>	<b>70,360</b>
Inventory	6,368	6,696	8,155	6,730	6,563	8,236	9,334	10,258
Debtors	6,650	9,206	18,138	12,828	15,619	15,202	19,474	21,401
Cash & Bank	1,810	1,175	1,593	1,314	1,367	1,413	6,572	16,835
Loans & Adv, Others	14,020	12,035	13,780	17,149	15,889	17,556	19,896	21,865
<b>Curr Liabs &amp; Provns</b>	<b>42,008</b>	<b>44,730</b>	<b>39,490</b>	<b>35,159</b>	<b>41,686</b>	<b>44,583</b>	<b>50,566</b>	<b>55,570</b>
Curr. Liabilities	27,610	28,787	31,494	34,187	40,543	42,835	48,545	53,351
Provisions	14,399	15,943	7,997	973	1,143	1,747	2,021	2,219
<b>Net Current Assets</b>	<b>-13,161</b>	<b>-15,618</b>	<b>2,175</b>	<b>2,861</b>	<b>-2,249</b>	<b>-2,176</b>	<b>4,709</b>	<b>14,790</b>
<b>Total Assets</b>	<b>54,408</b>	<b>56,243</b>	<b>65,727</b>	<b>90,569</b>	<b>105,256</b>	<b>122,805</b>	<b>136,165</b>	<b>152,265</b>

## Financials and Valuations

### Ratios

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
<b>Basic (INR)</b>								
EPS	106.1	105.6	125.0	158.2	169.1	185.1	193.4	219.0
Cash EPS	120.2	118.1	146.5	180.2	193.8	213.0	223.6	251.4
Book Value	250.7	280.4	327.6	442.4	506.3	589.3	656.2	735.0
DPS	60.0	65.0	60.0	72.0	85.0	95.0	105.0	115.0
Payout (incl. Div. Tax.)	65.1	70.8	57.8	52.3	57.8	59.0	62.4	60.4
<b>Valuation(x)</b>								
P/E	30.6	30.7	26.0	20.5	19.2	17.5	16.8	14.8
Price / Book Value	12.9	11.6	9.9	7.3	6.4	5.5	4.9	4.4
EV/Sales	2.6	2.4	2.2	2.1	2.1	1.8	1.6	1.4
EV/EBITDA	18.7	17.1	17.4	13.5	12.7	10.8	9.8	8.7
Dividend Yield (%)	1.8	2.0	1.8	2.2	2.6	2.9	3.2	3.5
<b>Profitability Ratios (%)</b>								
RoE	45.6	39.8	41.1	41.1	35.7	33.8	31.1	31.5
RoCE	36.5	38.3	41.1	40.5	34.5	32.5	29.9	30.4
RoIC	96.8	167.4	121.7	85.3	77.3	80.0	81.6	85.7
<b>Turnover Ratios (%)</b>								
Asset Turnover (x)	4.4	4.5	4.2	3.1	2.7	2.6	2.7	2.6
Debtors (No. of Days)	11	14	25	17	21	18	21	21
Inventory (No. of Days)	10	10	11	9	9	10	10	10
Creditors (No. of Days)	29	33	38	34	42	38	38	38
<b>Leverage Ratios (%)</b>								
Net Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1

### Cash Flow Statement

(INR Million)

Y/E Mar	2013	2014	2015	2016	2017	2018	2019E	2020E
Adjusted EBITDA	32,845	35,401	35,422	44,550	46,348	52,802	57,804	63,919
Non cash opr. exp (inc)	-137	-101	-1,471	2,425	3,195	2,908	5,025	6,100
(Inc)/Dec in Wkg. Cap.	-7,872	545	-3,359	2,504	-1,527	-2,682	-1,726	182
Tax Paid	-6,133	-6,495	-9,998	-11,032	-11,865	-14,943	-18,177	-19,697
Other operating activities	-5,741	795	2,519	1,834	4,129	1,723	50	50
<b>CF from Op. Activity</b>	<b>12,961</b>	<b>30,145</b>	<b>23,113</b>	<b>40,280</b>	<b>40,280</b>	<b>39,809</b>	<b>42,976</b>	<b>50,555</b>
(Inc)/Dec in FA & CWIP	-6,004	-9,328	-11,530	-14,604	-11,491	-7,992	-12,500	-12,500
<b>Free cash flows</b>	<b>6,957</b>	<b>20,818</b>	<b>11,583</b>	<b>25,676</b>	<b>28,790</b>	<b>31,816</b>	<b>30,476</b>	<b>38,055</b>
(Pur)/Sale of Invt	5,079	-6,866	11,651	-8,203	-7,949	-11,160	0	0
Others	0	0	0	0	0	0	0	0
<b>CF from Inv. Activity</b>	<b>-925</b>	<b>-16,193</b>	<b>121</b>	<b>-22,807</b>	<b>-19,439</b>	<b>-19,152</b>	<b>-12,500</b>	<b>-12,500</b>
Inc/(Dec) in Net Worth	0	0	0	0	0	0	0	0
Inc / (Dec) in Debt	0	0	0	0	0	0	0	0
Interest Paid	-119	-118	-111	-49	-61	-63	-50	-50
Divd Paid (incl Tax) & Others	-10,444	-14,031	-22,194	-16,818	-20,896	-20,404	-25,267	-27,743
<b>CF from Fin. Activity</b>	<b>-10,563</b>	<b>-14,149</b>	<b>-22,305</b>	<b>-16,867</b>	<b>-20,956</b>	<b>-20,467</b>	<b>-25,317</b>	<b>-27,793</b>
<b>Inc/(Dec) in Cash</b>	<b>1,473</b>	<b>-197</b>	<b>928</b>	<b>606</b>	<b>-116</b>	<b>190</b>	<b>5,159</b>	<b>10,262</b>
Add: Opening Balance	337	1,373	664	707	270	154	1,413	6,572
<b>Closing Balance</b>	<b>1,810</b>	<b>1,175</b>	<b>1,592</b>	<b>1,313</b>	<b>154</b>	<b>344</b>	<b>6,572</b>	<b>16,834</b>

NOTES

Explanation of Investment Rating	
<b>Investment Rating</b>	<b>Expected return (over 12-month)</b>
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

\*In case the recommendation given by the Research Analyst becomes inconsistent with the investment rating legend, the Research Analyst shall within 28 days of the inconsistency, take appropriate measures to make the recommendation consistent with the investment rating legend.

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