

Stock Update

Near term hiccups; smooth ride ahead

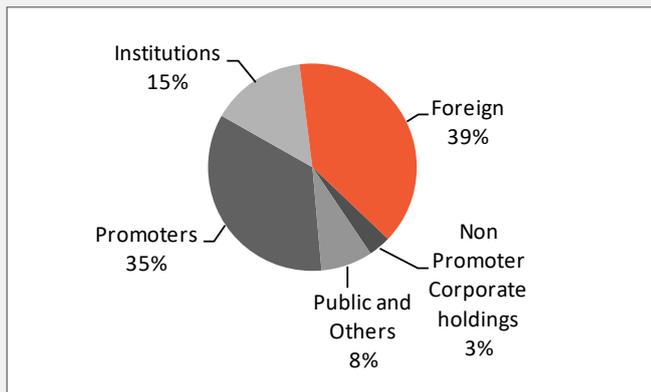
Hero MotoCorp

Reco: Hold | CMP: Rs3,320

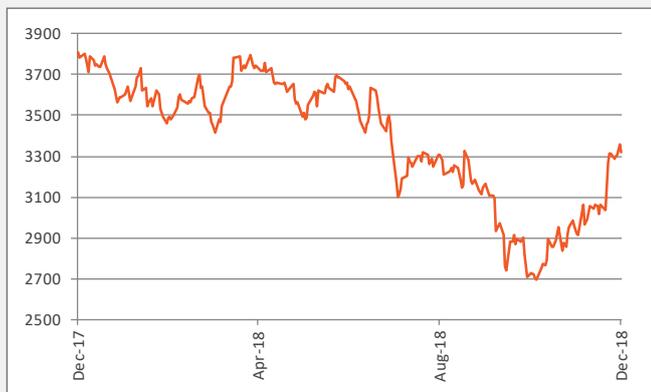
Company details

Price target:	Rs3,675
Market cap:	Rs66,306 cr
52-week high/low:	Rs3,862/2,649
NSE volume: (No of shares)	5.1 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Sharekhan code:	HEROMOTOCO
Free float: (No of shares)	13.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.6	6.6	-7.0	-7.9
Relative to Sensex	10.6	8.4	-9.9	-15.7

Key points

- Demand to remain flat in near term; expect gradual improvement from Q4FY2019:** Hero Motocorp Ltd (HMCL) volumes have been under pressure led by moderation in the 2W demand on the back of higher mandatory insurance costs for 2W, NBFC liquidity squeeze, rise in fuel prices. The festive demand moderated (festive demand growth at retail level was 7-8% which is lower than historical average) leading to higher channel inventory in the system. Currently, HMCL has about 6 weeks of inventory as against norm of four weeks and would resort to inventory correction. We expect HMCL to report flat volumes in December 2018 (second consecutive month of flat growth). Given the reduction in fuel prices, robust rural demand and easing of liquidity situation (The Government has announced measures to inject liquidity in economy), HMCL volumes would improve gradually from Q4FY2019. We expect HMCL to report double digit volume growth from Q4FY2019.
- Higher input costs coupled with competitive pressures to result in earnings remaining in declining trend in H2FY2019; expect double digit growth to resume from FY2020:** Commodity prices especially steel have witnessed significant uptick in the past four to five months. The impact of the cost increases will be felt till end of Q4FY2019 as OEMs typically have long term contracts for steel prices. Further, adverse currency movement (INR has depreciated by 3-4% both against USD and JPY) would also add costs for HMCL (imported raw materials form about 10% of sales). Moreover, intense pricing pressures (due to aggressive pricing strategy adopted by rivals) would also impact margins. We expect HMCL margins to decline 110 bps in H2FY2019 and expect earnings to drop 5% in H2FY2019. We expect earnings to resume double digit trend in FY2020 driven by recovery in volumes, easing of cost pressures and steady tax rate. We expect Hero to maintain margins in FY2020.
- Outlook- Earnings to remain under pressure in H2FY2019; expect improvement in FY2020:** Given the margin pressures on the back of higher input costs and increased competitive intensity,

HMCL margins are expected to drop ~100 bps in H2FY2019. Further, given the increased tax rates (due to expiry of fiscal incentives at Haridwar plant tax rates have shot up to 32% as against 29% in FY2018), we expect HMCL earnings to drop 5% in H2FY2019. HMCL earnings would resume double digit growth in FY2020 driven by improved demand scenario.

- ♦ **Valuation- Marginally raise estimates on improving demand outlook; retain Hold with revised PT of Rs 3,675:** Given the improved demand outlook led by easing of liquidity crunch, robust rural demand and steep correction in fuel prices we have marginally raised our earnings estimates. We have increased our FY2019 and FY2020 estimates by 1% and 4% respectively. We retain Hold rating on the stock with a revised PT of Rs 3,675 (earlier PT of 3,250).

Valuations

Particulars	Rs cr				
	FY16	FY17	FY18	FY19E	FY20E
Net Sales	28442.7	28500.5	32230.5	35373.7	39901.9
Growth (%)	3.1	0.2	13.1	9.8	12.8
EBIDTA	4455.0	4634.8	5280.2	5342.2	5946.3
OPM (%)	15.7	16.3	16.4	15.1	14.9
PAT	3160.2	3377.1	3697.4	3571.0	3973.7
Growth (%)	24.4	6.9	9.5	-3.4	11.3
FD EPS (Rs)	158.2	169.1	185.1	178.8	199.0
P/E (x)	21.0	19.6	17.9	18.6	16.7
P/B (x)	7.5	6.6	5.6	5.0	4.4
EV/EBIDTA (x)	13.8	13.0	11.1	10.8	9.5
RoE (%)	35.8%	33.4%	31.4%	26.9%	26.7%
RoCE (%)	48.7%	44.0%	42.4%	38.2%	38.2%

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