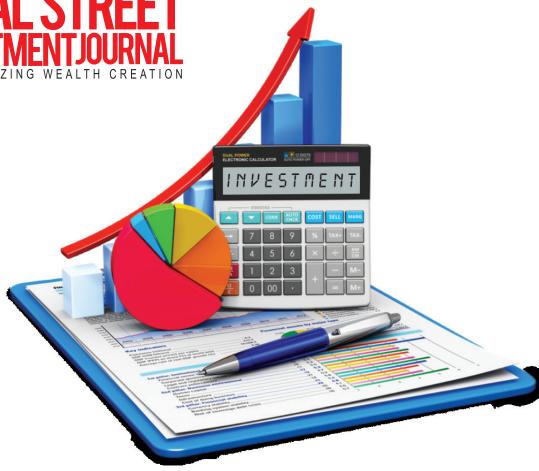


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DALAL STREET INVESTMENT JOURNAL

DEMOCRATIZING WEALTH CREATION



VALUE PICK
CHASING VALUE, NOT PRICES

May 2020

Company Name : HERO MOTOCORP

BSE Code : 500182

Time Duration : 2 year

CMP : ₹2241.25 (as on 14 May, 2020)

Target Price : ₹3093

Value Pick for the month of May is Hero MotoCorp. It is the world's single-largest two-wheeler motorcycle company with a market share of 36 per cent. It has its presence in both the motorcycles and the scooter segments, having a market share of about 51 per cent and 11 per cent, respectively. The company's key revenue driver is the motorcycles' segment, which accounts for almost 90 per cent of its total sales volume and the rest comes from scooters' division. In terms of motorcycles' segment, the entry level bikes (75 cc to 110 cc) account for almost 70 per cent of the company's total volume. The company's main focus is on the domestic market, where it sells nearly 97 per cent of its total units.

Well-poised to rise post COVID-19

Hero MotoCorp is a market leader and has a strong presence in the rural region as more than 50 per cent of its overall volumes come from these regions. At present, the entire nation is under lockdown but the government has intended to ease this lockdown and let the wheel of economic activities rotate. As a result of social distancing awareness, post this pandemic, people would prefer using their own personal vehicles rather than travelling via public transport. This would result in an increasing demand of two-wheelers and thus, a boost for companies like Hero MotoCorp. Notably, the company has a strong position in the entry level bikes (75 cc to 110 cc), which accounts for almost 70 per cent of the company's total volume. The company has resumed its production by re-opening nearly 1,500 of its retail outlets. The company received a healthy response from these outlets and retail sales crossed the mark of 10,000 units, which indicates the company's strong positioning in the market. Besides, if this pandemic comes under control before the festival season, then there would be healthy demand during the festival season for the company's product. Further, the government's stimulus package is also likely to revive the economy which in turn, would benefit the industry players like Hero MotoCorp.

Relatively Well-positioned amid transition to BS-VI

The company's management in its conference call has highlighted that its unsold BS-IV inventory as on March 22, 2020 was at 1.5 lakh units, which are far less than what D-street was esti-

mating. As per FADA, the overall two-wheeler industry is sitting with around seven lakh units of BS-IV inventory. Hero MotoCorp enjoys nearly 36 per cent of the market share while, its share in BS-IV inventory is relatively lower i.e. at 20 per cent. Besides, the management has stated that the company has continued online sales post the lockdown period, which would result in further correction of BS-IV inventory. As per Supreme Court's order, sales till March 31, 2020 will be allowed to register after 10 days of lifting the lockdown. Further, dealers will be allowed to sell 10 per cent of the unsold inventory post March 31, 2020 (after lifting of the lockdown), which would further reduce the impact on Hero MotoCorp. Notably, the company's management has said that over 95 per cent of the company's portfolio has already been launched in BS-VI.

Aims to launch e-carb in entry bikes

E-carb has much better pricing than the fuel injection systems. The company is working on the introduction of e-carburetors in the entry-level bikes to comply with BS-VI emission norms. Resultant, this would bring down the cost of entry bikes as compared to fuel injection bikes. The company's peers have already launched bikes with an electronic injection system, which is less expensive than fuel injection systems. We believe that with the launch of low-price models, the company's entry level product portfolio would be in a better position to compete in the post BS-VI era. Further, this would help the company to sustain its market share and maintain leadership position in 2W industry.

Financial performance

Before this pandemic, the auto industry was already going through a challenging time, which can be seen in the company's financial performance. In the third quarter of FY20, the company's net sales were at Rs 6,996.73 crore, down by 11 per cent from the same quarter of the previous year. Its EBITDA for the quarter was down marginally by ~6 per cent YoY to Rs 1,039 crore with a corresponding margin expansion of 80 bps. EBITDA margin for the period was at 14.85 per cent. PAT grew by 14.5 per cent YoY to Rs 880.4 crore while, PAT margin during the period improved to 12.58 per cent from 9.78 per cent in Q3FY19.

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Valuation & outlook

Looking at the current situation in the short-term, the company has to go through some painful situation and take a hit on the income statement but the management has stated that the company has a strong liquidity position of more than Rs 4,000 crore, which gives cushion during such a crisis. But post resumption of activity, there would be some pent-up demand and we believe that being a market leader, Hero MotoCorp will grab a major pie of this demand. Besides, we also believe that this painful situ-

ation has been factored in the stock price, which is currently available at P/E multiple of around 11.67 on TTM earning as against its historical median P/E of 22.3x. Thus, entry at the current level provides enough margin of safety. Once this pandemic gets under control, then it would bring cheer to the entire economy. Thus, considering Hero MotoCorp's leadership position, a strong balance sheet and return ratios (~41 per cent ROCE and ~28 per cent ROE) along with 50 per cent dividend payout ratio, we recommend a BUY on the stock with a target of Rs 3,093 representing a potential upside of 38 per cent.

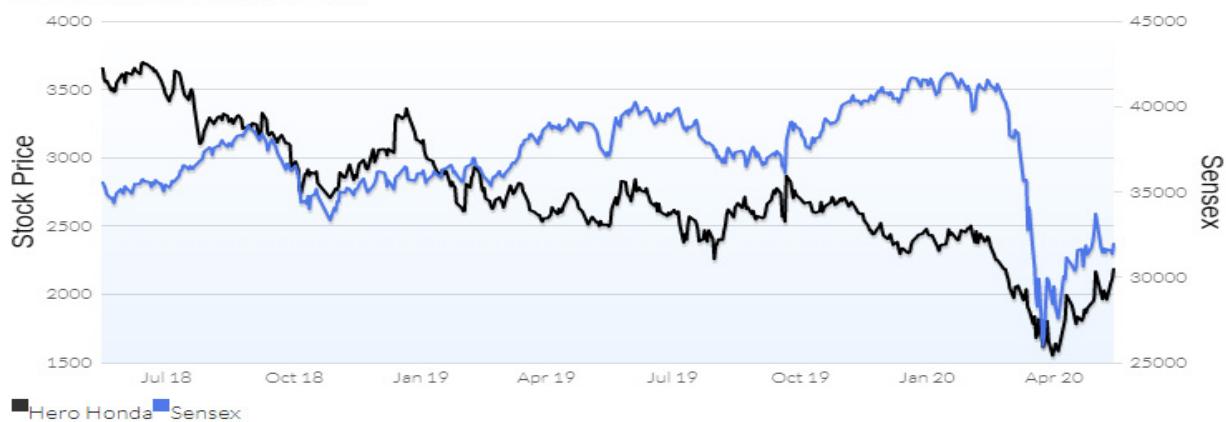
Inc/Exp Statement (Standalone)

Description	201903	201803	201703	201603	201503
Net Sales	33650.54	32230.49	28500.46	28442.7	27585.3
Total Income	34341.79	32756.31	29022.89	28865.13	28168.82
Total Expenditure	28720.45	26950.3	23865.65	23987.73	24133.9
PBIDT	5621.34	5806.01	5157.24	4877.4	4034.92
PAT	3384.87	3697.36	3377.12	3160.19	2385.64
Dividend %	4350	4750	4250	3600	3000
Adj. EPS(Rs)	169.46	185.15	169.11	158.25	119.46

Quarter On Quarter (Standalone)

Particulars	201912	201909	Q on Q Var %	201812	Y on Y Var %
Net Sales	6996.73	7570.7	-7.58	7864.82	-11.04
Total Expenditure	5957.76	6469.58	-7.91	6760.05	-11.87
PBIDT (Excl OI)	1038.97	1101.12	-5.64	1104.77	-5.96
PAT	880.41	874.8	0.64	769.1	14.47
PBIDTM% (Excl OI)	14.85	14.54	2.13	14.05	5.69
PBIDTM%	17.45	17.29	0.93	16.43	6.21
PATM%	12.58	11.56	8.82	9.78	28.63
Adj. EPS(Rs)	44.08	43.79	0.66	38.51	14.46

Stock vs. Index



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