October 13, 2022

Hero MotoCorp Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	-	-	[ICRA]AAA(Stable); Reaffirmed
Non-convertible Debenture Programme	15.0	15.0	[ICRA]AAA(Stable); Reaffirmed
Fund-based and Non-fund Based Limits	840.0	960.0	[ICRA]AAA(Stable)/[ICRA]A1+; Reaffirmed
Unallocated	260.0	140.0	[ICRA]AAA(Stable); Reaffirmed
Total	**1,115.0**	**1,115.0**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings of Hero MotoCorp Limited (HMCL) factors in its strong business profile, as evidenced by its market leadership in the domestic two-wheeler (2W) industry (market share of ~35%[1] and ~48% in the overall 2W and motorcycle segments, respectively), its robust product portfolio, established brands and well entrenched dealership network. The ratings also continue to favourably factor in its strong financial profile, as reflected in its robust return and credit metrices and superior liquidity position.

The 2W industry witnessed a third consecutive year of contraction in FY2022. In contrast to FY2021, the rural markets were disproportionately impacted by the pandemic's second wave (in Q1 FY2022) and have been slower to recover. In addition, the rise in vehicle prices (to offset commodity price escalations), high petrol prices and general inflationary headwinds, amid job losses and income uncertainty, have dented consumer sentiments. Given the higher proportion of rural sales, HMCL saw higher than industry decline in domestic volumes (17% decline vis-à-vis 11% for the industry) in FY2022. However, it saw a robust 57% YoY growth in exports (vis-à-vis 35% for the industry; albeit on a relatively low base) with record sales of over 3 lakh units in the year. While the negative operating leverage and commodity price pressures led to moderation in company profitability (operating profit margin fell from 13.3% in FY2021 to 11.7%[2]) in FY2022, ICRA notes that timely cost containment initiatives and price hikes taken by the company protected its per unit profitability. In YTD FY2023, in line with industry, while HMCL's domestic sales have witnessed a steady recovery, bolstered by the marriage season (April–May 2022) and gradual reopening of the economy, exports are facing headwinds due to inflationary pressures and forex availability in key markets. Going forward, while elevated cost of ownership and high inflation remain a challenge, relatively normal monsoons and healthy crop procurement are expected to support rural cash flows and 2W demand during the festive season. This is expected to augur well for HMCL's revenue growth prospects.

The rating continues to factor in the strong financial profile of the company, evidenced by its healthy profitability (average OPBDITA and core ROCE of ~14% and ~70%, respectively, over the past five years, despite two years impacted by the pandemic) and cash accruals, negative net debt position and robust liquidity profile (cash balances and investments of over Rs. 8,000 crore as on March 31, 2022). Over the years, HMCL's management has followed a prudent approach for growth. As a result, despite facing muted demand over the past three years and undertaking significant capex (towards setting up greenfield manufacturing units and investments towards a BS-VI compliant portfolio), the dependence on external borrowings has

[1] *Market share for FY2022 as derived from SIAM data.*

[2] *Financial ratios in the document are ICRA adjusted figures and may not be directly comparable with results reported by the company in some instances*

remained negligible. It is expected to remain so in the medium term as well, even as the company is likely to step-up its investments towards alternative fuel technologies and products.

HMCL continues to invest in its investee company in financial services business – Hero FinCorp Limited (or HFCL), evidencing the latter's strategic importance. ICRA would continue to monitor the performance of HMCL's investee companies – HFCL and others - and any material support from HMCL, resulting in weakening of its liquidity position, will be monitorable.

ICRA notes that HMCL's performance remains exposed to challenges such as increasing regulatory interventions (emission norms, safety norms) and fierce competition in the domestic 2W market. Additionally, the heavy revenue dependence on the domestic market (~95%) and limited (albeit growing) presence in the premium motorcycles and scooter segment, exposes it to adverse demand trends in the domestic/rural markets. A structural shift in preference for electric 2Ws (e-2W) (as opposed to conventional 2Ws) also remain a medium-to-long-term challenge. However, HMCL's proven ability to adapt to the changing customer requirements and multipronged strategies to enhance presence in these segments, mitigate the above risks to some extent. In addition, its consistent investments in HFCL for supporting 2W financing indicate its focus on developing a favourable financing ecosystem and is expected to aid in its growth plans.

The Stable outlook on the long-term rating reflects ICRA's expectation that HMCL is likely to maintain its leadership position in the Indian 2W industry, aided by its strong product portfolio, established brands, extensive dealership network and regular investments in new model launches as well as R&D for future technologies. The same is likely to help HMCL successfully navigate the uncertainties caused by structural shifts in the industry or any other exogenous shocks, while maintaining a strong credit profile.

Key rating drivers and their description

Credit strengths

Market leader in the Indian 2W market with wide dealership network and strong rural connect - HMCL reported annual global sales of 4.9 million units in FY2022 and maintained its market leadership in the Indian 2W market with a ~35% market share (domestic). Among the 2W segments, HMCL is a market leader in the domestic motorcycle segment with a ~48% share (in FY2022); it is also among the top four OEMs in the scooter segment; albeit with a low market share of ~8% in FY2022. With new product launches in motorcycles, especially in the premium as well as scooter segments, HMCL is likely to maintain its leadership position in the Indian 2W industry. Its strong brand equity, well-entrenched distribution network and wide product offerings will continue to aid in the same. HMCL has more than 9,000 customer touch points (globally) with a deep-rooted rural presence in India, making it one of the strongest sales networks among all 2W manufacturers.

Strong product portfolio with established brands - The company had four brands in the top 10 motorcycles and two models in top 10 scooters sold in India for FY2022, the highest among 2W OEMs. HMCL's strong brands include Splendor, HF Deluxe and Passion, which account for nearly 70% of the total volumes of its entry level sub-segment. The OEM's dominance in the largest 2W sub-segment, expectation of improving presence in other sub-segments and product categories (scooters, e-2Ws) support healthy revenue visibility for the company.

Robust financial risk profile - HMCL's strong financial profile is evidenced by a conservative capital structure (TD/TNW of Nil and TOL/TNW of 0.4x as on March 31, 2022) and a negative net debt position at a consolidated level (zero debt on a standalone basis). Despite contraction in operating profits and revenues in FY2022, the core RoCE of the business, on a consolidated level, stood at ~50% for FY2022, driven by high asset utilisation. Additionally, the company has a strong liquidity profile, with over Rs. 8,000 crore of cash and investments, as of March 31, 2022.

Credit challenges

Relatively low share in export markets; remains susceptible to vagaries of rural demand sentiment - The company is largely dependent on the domestic market, which accounted for 94% of total volumes dispatched in FY2022. While it increased its presence in overseas markets and crossed the 300,000-unit export (in an annum) milestone during FY2022, the contribution of exports to total sales and overall market share of HMCL in exports remained modest at 6-7% in FY2022. Nevertheless, the company continues to expand and deepen its presence in export markets with a target of 15% export revenues by FY2025. A better domestic–export mix could provide a cushion in case of slowdown in domestic demand.

HMCL has a higher dependence on products in the entry and executive sub-segments of motorcycles, which primarily has income-sensitive rural and semi-urban clientele. Given the impact of the severe second pandemic wave on rural India, HMCL saw a higher than industry decline in domestic volumes in FY2022. While HMCL has launched several new products in the premium commuter motorcycle (150-200cc) and scooter segments to attract urban customers over the past few years, its market share in these segments remain modest (<10%; albeit improved on YoY basis in FY2022 and YTD FY2023). The company started distribution of Harley Davidson motorcycles from April 2021 and garnered a market share of 37% in the 1,000cc+ segment in FY2022; however, development of new premium products to enhance HMCL's premium segment presence, will be ascertainable over the near to medium term. The company's focus on new product launches to gain market shares in other segments would remain critical for it to reduce its susceptibility to demand downturns for the entry and executive level segments.

Increasing competition in domestic 2W market; structural transition to e-2Ws over medium to long term - The Indian 2W industry is highly competitive with regular new product launches and refreshes by several OEMs to gain market share. Aided by successful migration to BS-VI technology for its product portfolio and revamped 125cc scooters and new motorcycles in the premium segment, HMCL intends to improve its market share across segments and sub-segments. Consequently, consistent investment in R&D, network expansion and introduction of newer models/refreshes remains crucial for HMCL to maintain its leadership position in the Indian 2W market.

As a market leader in conventional 2Ws, HMCL remains exposed to risk of a structural shift in customer preferences towards e-2Ws over the medium to long-term. HMCL has adopted a multi-pronged strategy to capitalise on the opportunities presented in this space—investment in Ather Energy and the US-based Zero Motorcycles (for developing premium e-2Ws), in-house R&D efforts to develop e-2Ws (first product launched under brand "VIDA" in October 2022, along with its EV ecosystem), collaboration with Taiwan-based Gogoro to venture into battery swapping infrastructure (and 2W models) and tie-up with Bharat Petroleum Company Limited (BPCL) and Hindustan Petroleum Company Limited (HPCL) for setting up charging stations across the country. However, all these ventures are in nascent stages and their success remains to be seen over the medium term.

Environmental and Social Risks

Environmental considerations - HMCL derives a material share of demand for its 2Ws from the rural segment and, hence, any adverse climatic conditions such as droughts and floods may impact farm incomes and, consequently, the earning prospects of entities. It also remains exposed to climate transition risks emanating from a likelihood of tightening emission control requirements, with the Government focused on reducing the adverse impact of automobile emissions. Accordingly, HMCL's prospects remain linked to its ability to meet these tightening emission requirements. HMCL (and the 2W industry as a whole) may need to invest materially to develop products to meet the regulatory thresholds or expected transition to alternative fuel vehicles (like e-2Ws), which may have a moderating impact on their return and credit metrics. The exposure to litigation/ penalties arising from issues related to waste and water management for the company remains relatively low.

Social considerations - HMCL has a healthy dependence on human capital and, hence, retaining its human capital, maintaining healthy employee relations as well as supplier ecosystem remains essential for disruption free operations. Another social risk that automotive OEMs, like HMCL, face pertains to product safety and quality, wherein instances of product recalls and high warranty costs may not only lead to a financial implication but could also harm brand reputation and create a more long-lasting adverse impact on demand. The entities also remain exposed to any major shift in consumer preferences/ demographics, which are a key driver for demand and, accordingly, may need to make material investments to realign their product portfolio.

Liquidity position: Superior

HMCL's liquidity is **superior** as reflected by strong cash and liquid investments of nearly ~Rs. 6,050 crore, non-current investments in debentures/FMPs of ~Rs. 2,300 crore and unutilised working capital bank limits of nearly Rs. 850 crore as on March 31, 2022. Additionally, healthy accruals from the business, coupled with negligible debt obligations and favourable working capital cycle, drive the company's strong financial profile. Over the next 12-15 months, the entire planned investments and capex are expected to be funded through internal accruals. Despite prevailing demand uncertainties, ICRA expects the company to continue maintaining its superior liquidity position.

Rating sensitivities

Positive factors – Not applicable

Negative factors – A sharp and sustained contraction in profitability metrics or significant erosion in market share on a sustained basis amid increasing competition, or any sizeable debt-funded inorganic/organic growth plans leading to material deterioration in credit metrics, or any sizeable cash outflow in the form of dividends or buybacks that sharply depletes the currently robust liquidity, could be triggers for a downward rating review.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Two-wheeler Manufacturers Rating approach- Consolidation
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone assessment of HMCL while factoring in the ordinary and extraordinary support that the company is expected to extend to its associate company in financial services business. The ratings are based on the consolidated financial statements of HMCL. As on March 31, 2022, the company had four subsidiaries, two step-down subsidiaries and two associate companies, which are enlisted in Annexure-II.

About the company

HMCL is engaged in manufacturing and marketing motorcycles and scooters. It is the largest two-wheeler manufacturer in the world. In India, it commanded a market share of ~35% in FY2022. The company has eight manufacturing facilities with an annual production capacity of 9.5 million units. Of the same, six plants are in India—one each at Dharuhera and Gurgaon (both in Haryana), Haridwar (Uttaranchal), Neemrana (Rajasthan), Halol (Gujarat), Chitoor (Andhra Pradesh)—while two are overseas at Columbia and Bangladesh. Additionally, the company has also set up an R&D centre at Jaipur (India) and Germany. Backed by a large product portfolio across various price segments, HMCL is a market leader in the domestic motorcycle industry with a share of 48.3% in FY2022 (PY: 51.5%). It also has presence in the domestic scooter market, albeit its market share was modest at 7.7% in FY2022 (PY: 9.9%).

HMCL had commenced operations as Hero Honda, a joint venture company (both promoters holding 26% of equity) between Hero Cycles Limited and Honda Motor Company (HMC), Japan, in January 1984. In January 2011, HMC agreed to transfer its entire shareholding of 26% to the Hero Group, thus bringing an end to the partnership. The company is listed on the BSE and NSE. The BM Munjal family, led by Mr. Pawan Kant Munjal, holds ~34% stake in HMCL.

Key financial indicators (audited)

HMCL Consolidated	FY2021	FY2022	Q1FY2023
Operating Income (Rs. crore)	30,959.2	29,551.3	8,447.5
PAT (Rs. crore)	2,982.6	2,528.1	585.6
OPBDIT/OI (%)	13.3%	11.7%	11.1%
PAT/OI (%)	9.6%	8.6%	6.9%
Total outside liabilities/Tangible net worth (times)	0.5	0.4	-
Total debt/OPBDIT (times)	0.1	0.2	-
Interest coverage (times)	88.4	65.3	67.6

Source: Company Annual Reports/ Limited Quarterly results; ICRA Research
PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

Sl. No.	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					Oct 13, 2022	Oct 1, 2021 Jul 28, 2021	Jul 31, 2020	Aug 19, 2019 Jun 21, 2019
1	Issuer Rating	Long term	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Non-convertible Debenture Programme	Long term	15.0	*	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
3	Fund-based and Non-fund Based Limits	Long term/ Short term	960.0	-	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+
4	Unallocated	Long term	140.0	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)

**The company has not issued any NCDs*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Issuer Rating	Not Applicable
Long Term-Bonds/NCD/LTD*	Simple
Long Term/Short Term - Fund Based and Non-Fund Based Limits	Simple
Long-Term-Unallocated	Not Applicable

**Not placed/Issued yet; subject to change once the terms are finalized*

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer rating	-	-	-	-	[ICRA]AAA(Stable)
NA	Non-convertible Debenture Programme*	Yet to be issued			15.00	[ICRA]AAA(Stable)
NA	Fund-based and Non-fund Based Limits	NA	NA	NA	960.0	[ICRA]AAA(Stable)/ [ICRA]A1+
NA	Unallocated	NA	NA	NA	140.0	[ICRA]AAA(Stable)

*Source: HMCL. * The company has not issued any NCD as on date.*

Annexure II: List of entities considered for consolidated analysis

Company Name	HMCL Ownership	Consolidation Approach
HMCL	Rated Entity	Full consolidation
HMCL Americas Inc.	100.0%	Full Consolidation
HMCL Netherlands B.V.	100.0%	Full Consolidation
Hero Tech Center Germany GmbH	100.0%	Full Consolidation
HMCL Colombia S.A.S (through HMCL Netherlands B.V)	68.0%	Full Consolidation
HMC MM Auto Limited	60.0%	Full Consolidation
HMCL Niloy Bangladesh Limited (through HMCL Netherlands B.V)	55.0%	Full Consolidation
Hero FinCorp Limited	41.2%	Equity Method
Ather Energy Private Limited	37.7%	Equity Method

Source: HMCL annual report FY2022

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