

July 31, 2020

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	15.00	15.00	[ICRA]AAA(Stable); reaffirmed
Fund-based and Non-fund Based Limits	905.10	905.10	[ICRA]AAA(Stable)/[ICRA]A1+; reaffirmed
Unallocated	194.90	194.90	[ICRA]AAA(Stable); reaffirmed
Total	1,115.00	1,115.00	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation continues to factor in the strong business profile of Hero MotoCorp Limited (HMCL) as evidenced by its market leadership in the domestic two-wheeler industry with an overall market share of 35.7%¹ and 52% market share in the motorcycle segment, its strong product portfolio, established brands and well entrenched dealership network. The rating also factors in the company's robust financial profile demonstrated by healthy profitability indicators, credit metrics and strong liquidity profile.

The Covid-19 pandemic in Q4 FY2020 exacerbated the already weak two-wheeler demand environment, and additionally disrupted OEM supply chains. In adherence to the nationwide lockdown, HMCL completely shut down its production between March 22, 2020 and May 4, 2020. This impacted clearance of BS-IV stocks (in the last fortnight of FY2020) and delayed the ramp-up of BS-VI production, resulting in slowdown in dispatches. In line with the domestic two-wheeler industry, HMCL also witnessed a ~18% YoY decline in sales volumes in FY2020. HMCL was the first to resume operations in May 2020, followed by other OEMs. However, ICRA takes cognizance of the near-term challenges (demand and supply) due to the pandemic and expects a 16-18% contraction in the two-wheeler industry volumes in FY2021. The industry will be facing multiple headwinds of higher ownership cost for BS-VI compliant vehicles and reduced discretionary and overall spending owing to uncertainties related to personal incomes amid a weak economic environment. Nonetheless, preference for personal mobility solutions (to adhere to social distancing norms) and early recovery witnessed for rural demand (led by a healthy Rabi harvest, Kharif sowing and overall lower disruption caused by the pandemic) are expected to augur well for HMCL, which has a significant rural clientele.

In line with the industry, HMCL is also expected to witness a contraction in FY2021 in terms of demand and earnings. Despite the same, the rating continues to factor in the strong financial profile of the company, evidenced by its healthy profitability (average OPBDITA and core ROCE of ~15.5% and ~95%, respectively, over the past five years) and cash accruals, negative net debt position and robust liquidity profile (cash balances and liquid investments of ~Rs. 6,550 crore as on March 31, 2020). Over the years, HMCL's management has followed a pragmatic approach for growth. As a result,

¹ Market share for FY2020

despite facing muted demand over the past two 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 remained negligible. Even as the company is expected to utilise internal accruals for a proposed capex of Rs. 550-600 crore in FY2021 and incur incremental strategic investments (predominantly in Ather Energy Private Limited, or Ather, and Hero FinCorp Limited, or HFCL), the management's prudent track record provides comfort.

To diversify its product mix and reduce its dependence on the entry (75-110cc) and executive (110-125cc) segments of motorcycle and rural markets, the company has taken several initiatives. These include investments towards launching products in the premium motorcycle segment as well as scooter segment, which have a more urban clientele. Over the past two years, HMCL has launched four products from its 'X series' motorcycles in the 150-200cc displacement category and two products in 125cc scooter segment. Successful ramp-up of these new products could help consolidate HMCL's market position and diversify revenue streams.

ICRA notes the intense competition in the two-wheeler industry, with several domestic and foreign OEMs vying for market share through constant product launches at diverse price points. This necessitates consistent diversion of cash flows towards investment in new product development and future technologies, while remaining cost competitive. HMCL has invested over Rs. 4,350 crore in R&D between FY2014-FY2020 and is among the top OEMs in terms of research spends. It has also made consistent investments in Ather for securing its interests in the electric two-wheeler segment, as well as in HFCL for supporting two-wheeler financing, evincing its commitment in developing future technologies and a favourable financing eco-system.

The Stable outlook on HMCL's long-term rating reflects ICRA's expectation that it will continue to maintain its leadership position in the Indian two-wheeler industry aided by its strong product portfolio and established brands, regular investments in new model launches, and extensive dealership network. The same is likely to help HMCL successfully navigate through the uncertainties caused by the pandemic and maintain a comfortable financial risk profile.

Key rating drivers and their description

Credit strengths

Market leader in the Indian two-wheeler market with widest dealer network and strong rural connect - HMCL reported annual global sales of 6.4 million units in FY2020 and maintained its market leadership in the Indian two-wheeler market with a ~36% market share. In the two-wheeler segment, HMCL is a market leader in the motorcycle segment with a 52% share of the domestic market in FY2020. It is also among the top four OEMs in the scooter segment, with a market share of 7.2%. While the company has consistently maintained over 50% market share in the motorcycle segment over the years, its scooter segment share had been declining for the past four years due to lack of new products. Going forward, with new product launches in motorcycles, especially in the premium as well as scooter segments, it is likely to maintain its leadership position in the Indian two-wheeler industry aided by its strong brand equity, well-entrenched distribution network and wide product offerings. HMCL has more than 6,500 customer touch points with a deep-rooted rural presence, making it one of the strongest sales networks among all two-wheeler manufacturers in India.

Strong product portfolio with established brands - The company had four brands among India's top 10 motorcycles and three among the top 10 scooters sold in FY2020, the highest among any other two-wheeler OEM. The strong brands of HMCL are Splendor, HF Deluxe and Passion, which drive nearly 70% of its total volumes in the entry level sub-segment.

Given such dominance in the largest sub-segment of two-wheelers and new product launches in other sub-segments and product categories (scooters), HMCL is expected to further strengthen its presence in the Indian two-wheeler industry.

Robust financial risk profile- HMCL's strong financial profile is evidenced by its conservative capital structure (TD/TNW of Nil and TOL/TNW of 0.4x as on Mar 31, 2020) and a negative net debt position at a consolidated level. Despite contraction in operating profits and revenues in FY2020, the core RoCE of the business, on a consolidated level, stood at around 48% during FY2020 driven by high asset utilisation. Additionally, the company had a sizeable amount of cash and investments worth Rs. 6,550 crore as of March 31, 2020 (including FMPs). Maintaining its profitability and RoCE, amid weak demand sentiments and increasing competition, will remain a key rating sensitivity over the medium term.

Credit challenges

Limited presence in premium motorcycles segment; muted performance in scooter segment - While HMCL is a dominant player in the entry segment of motorcycles, it is a marginal player in the higher margin premium motorcycles segment. The company re-entered the higher displacement, 150-200cc sub-segment, with the launch of its 'X series' of motorcycles in FY2019; however, the ramp-up of these new models leading to market share gains remain to be seen. In the scooter segment, HMCL's absence from the high growth 125cc sub-segment had led to loss in market share over the past few years. However, the company has launched two 125cc scooters—Destini and Maestro—in the past two years. Despite the slowdown in demand for premium motorcycle and scooter segment in the recent past, these are likely to resume their growth trajectory and increase their share of 2W market once the industry recovers from current crisis. Successful ramp-up of its new products could help HMCL in gaining market share in these segments and reducing dependency on the motorcycle category.

High competition in domestic two-wheeler market - The Indian two-wheeler industry is highly competitive with regular new product launches and refreshes by OEMs to gain market share. Nonetheless, with successful migration to BS-VI technology for its product portfolio, coupled with launch of 125cc scooters and new motorcycles in the premium segment, HMCL intends to improve its market share in these segments. Consistent investment in R&D and introduction of newer models is crucial for HMCL to maintain its leadership position in the Indian two-wheeler market.

Relatively low share in export markets; remains susceptible to vagaries of rural demand sentiment- The company is significantly dependent on the domestic market, which accounted for 97% of total volumes dispatched in FY2020. While it is present in over 40 overseas markets, HMCL's share in total two-wheeler exports from India in FY2020 was muted at 5.1%. Also, most of its products in the entry and executive sub-segments of motorcycles have direct correlation with rural and semi-urban demand sentiments. While HMCL has developed new products in the premium motorcycle and scooter segments to address its urban clientele, the success of these products would be critical for it to reduce its susceptibility to volatile rural demand.

Liquidity position: Superior

HMCL's liquidity is **superior** as reflected by strong cash and investments of nearly Rs. 6,550 crore as on March 31, 2020, (including FMPs), expectation of stable cash flow generation and negligible debt repayment obligations. Healthy accruals from the business, coupled with negligible debt obligations and favourable working capital cycle, have enabled the company to maintain a superior liquidity profile, despite large capex undertaken in the last few years. For FY2021, the

entire planned investments of Rs. 550-600 crore in capex is also expected to be funded through internal accruals. Despite near term demand uncertainties, ICRA expects the company to continue to maintain a strong liquidity profile.

Rating sensitivities

Positive triggers – Not applicable

Negative triggers – A steep decline in sales volumes beyond FY2021 due to a prolonged impact of the ongoing pandemic leading to sharp 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 plan leading to material deterioration in credit metrics, or any sizeable cash outflow in 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
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial statements of the company. The list of consolidated entities are shared in Annexure-2

About the company

HMCL is engaged in manufacturing and marketing motorcycles and scooters and is the largest two-wheeler manufacturer in the world. In FY2020 it commanded a market share of 35.8% in India. With its Chittoor plant (Andhra Pradesh) becoming operational in FY2020, the company now has eight manufacturing facilities with an annual production capacity of 9.1 million units. Of these, six plants are in India—one each at Dharuhera and Gurgaon (both in Haryana), Haridwar (Uttaranchal), Neemrana (Rajasthan), Halol (Gujarat) and Chittoor—and two are overseas units at Columbia and Bangladesh. Additionally, the company has R&D facilities 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 market share of 52% (FY2020). It is also present in the domestic scooter market, with a market share of 7.2% in FY2020.

HMCL had commenced operations in January 1984 as Hero Honda, a joint venture company (both promoters holding 26% equity) between Hero Cycles Limited and Honda Motor Company (HMC), Japan. 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 BSE and NSE. The B.M. Munjal family, led by Mr. Pawan Kant Munjal, holds ~34% stake in HMCL.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	33,970.8	29,254.0
PAT (Rs. crore)	3,405.6	3,624.8
OPBDITA/ OI (%)	14.8%	14.0%
RoCE (%)	39.5%	32.3%
Total Outside Liabilities/Tangible Net Worth+ Minority Interest	0.4	0.4
Total Debt/ OPBDIT (times)	0.1	0.1
Interest Coverage (times)	135.3	87.7
DSCR (times)	97.9	70.0

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net Worth + Deferred Tax Liability - Capital Work in Progress)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

Sl. No.	Instrument	Type	Current Rating (FY2021)		Date & Rating 31-Jul-20	Chronology of Rating History for the past 3 years		
			Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)		Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
1	Issuer Rating	Long term	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Non-convertible Debenture Programme	Long term	15.00	*	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
3	Fund-based and Non-fund Based Limits	Long term/ Short term	905.10	-	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+	[ICRA]AAA (Stable)/ [ICRA]A1+
4	Unallocated	Long term	194.90	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)

*The company has not issued any NCDs

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer rating	-	-	-	-	[ICRA]AAA(Stable)
NA	Non-convertible Debenture Programme*	-	-	-	15.00	[ICRA]AAA(Stable)
NA	Fund-based and Non-fund Based Limits	NA	NA	NA	905.10	[ICRA]AAA(Stable)/ [ICRA]A1+
NA	Unallocated	NA	NA	NA	194.90	[ICRA]AAA(Stable)

Source: HMCL. * The company has not issued any NCDs.

Annexure-2: List of entities considered for consolidated analysis

Company Name	HMCL Ownership	Consolidation Approach
HMCL (NA) Inc.	100.00%*	Full Consolidation
HMCL Americas Inc.	100.00%	Full Consolidation
HMCL Netherlands B.V.	100.00%	Full Consolidation
Hero Tech Center Germany GmbH	100.00%	Full Consolidation
HMCL Colombia S.A.S	68.00%	Full Consolidation
HMC MM Auto Limited	60.00%	Full Consolidation
HMCL Niloy Bangladesh Limited	55.00%	Full Consolidation
Hero FinCorp Limited	41.19%	Equity Method
Ather Energy Private Limited	35.10%	Equity Method

Source: HMCL Annual Report FY2020

*Liquidated w.e.f. November 6, 2019

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