Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Hero MotoCorp Limited

Hero to keep shining

Automobiles	Sharekhan code: HEROMOTOCO	Company Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 3,101**	
Price Target: **Rs. 3,496**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

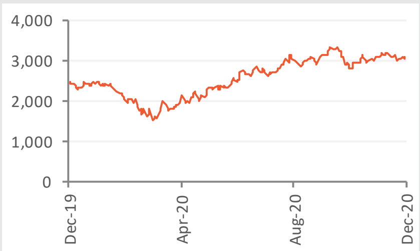
Company details

Market cap:	Rs. 61,948 cr
52-week high/low:	Rs. 3,394 / 1,475
NSE volume: (No of shares)	15.6 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.05 cr

Shareholding (%)

Promoters	34.8
FII	32.7
DII	21.5
Others	11.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.6	0.4	22.1	25.1
Relative to Sensex	-5.3	-25.3	-13.7	10.2

Sharekhan Research, Bloomberg

Summary

- We reiterate our Buy rating on Hero MotoCorp Limited (HMCL) with a PT of Rs. 3,496, after holding a call with the company's management.
- Interaction with the management indicates that structural growth traction in the two-wheeler (2W) industry remains intact. HMCL continues to benefit from premiumisation of its products, its stronghold in the economy and executive motorcycle segments, and aggressive products offerings in the premium bike and scooters segments.
- Exports, electric vehicles, and partnership with Harley Davidson are the next key growth drivers for the company in the long term.
- The stock is attractively valued with P/E multiple of 15.3x and EV/EBITDA multiple of 8.8x its FY2023E estimates and is at a 15%-20% discount to its long-term average multiples. We recommend Buy on the stock.

Our interaction with Hero MotoCorp's (HMCL) management indicated that the structural growth traction in the two-wheeler (2W) industry remains intact. HMCL continues to benefit from premiumisation of its products, its stronghold in the economy and executive motorcycle segments, and aggressive products offerings in premium bike and scooters segments. HMCL is a market leader in the Indian 2W industry, commanding a ~38.5% share. The company commands ~65% market share in the combined economy and executive motorcycle segment, which together makes up 80% of the motorcycle market size in India. HMCL has strong penetration in semi-urban and rural areas, aided by its largest distribution network in the 2W industry. We expect HMCL to be the beneficiary of rural demand and increased personal mobility. HMCL's brand equity is because of value-for-money products, extensive service centres, low maintenance cost and higher resale value. The company has raised its production capacity in anticipation of higher demand. The company is also making in-road in the premium bike segment in partnership with Harley Davidson. We expect strong recovery in FY2022, driven by normalisation of economic activities, operating leverage, price hikes, and cost saving under the company's leap programme, which would result in margin improvement. We expect HMCL to reach its historical margin range of 14%-16%. Hence, we retain our Buy rating on the stock.

Our Call

Valuation - Maintain Buy and PT of Rs. 3,496: Our interaction with HMCL's management underpins our positive outlook for the 2W industry. Structural demand for 2W remains strong and will drive growth post normalisation of economic activities, owing to improving personal income, increasing penetration in the rural economy, and 2W being the most preferred mode of personal transportation. We expect the 2W industry to end FY2021 with a decline of 15.6% y-o-y against a decline of 18.3% y-o-y YTD FY2021 (April-October), followed by strong 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E. Incremental growth is likely to come from economy and executive motorcycle segments, which are slated to grow by 11% y-o-y and 10.4% y-o-y in FY2022E, respectively, driven largely by rural and tier 2 and 3 cities. We expect HMCL to be the greatest beneficiary in the sector, given its leadership and largest distribution network. We have valued the stock by assigning P/E multiple of 17.2x, in-line with its average long-term P/E multiples on its FY2023E earnings to arrive at a PT of Rs. 3,496, providing an upside of 12.7% from current levels. The stock is attractively valued at P/E multiple of 15.3x and EV/EBITDA multiple of 8.8x its FY2023 estimates. We retain our Buy rating on the stock.

Key risk

Success of rival products in the entry and executive bike segments can impact HMCL's market share in the segments. The company is aggressively expanding its product portfolio in the premium bikes segment. Unsuccessful launches in the premium segment can restrain its growth path.

Valuation Rs cr

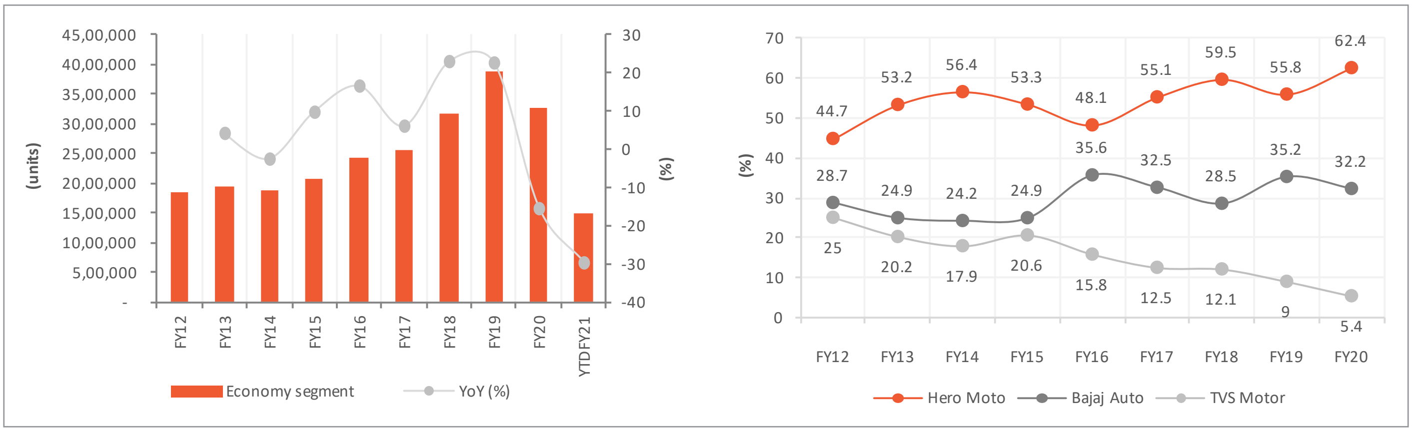
Particulars	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	33,651	28,836	28,212	33,477	38,587
Growth (%)	4.4	-14.3	-2.2	18.7	15.3
EBIDTA	4,930	3,958	3,682	4,822	5,632
OPM (%)	14.7	13.7	13.1	14.4	14.6
PAT (Rs cr)	3,385	3,179	2,670	3,460	4,053
Growth (%)	-8.5	-6.1	-16.0	29.6	17.2
FD EPS (Rs)	169.5	159.2	133.7	173.2	203.0
P/E (x)	18.3	19.5	23.2	17.9	15.3
P/B (x)	4.8	4.4	4.1	3.9	3.1
EV/EBIDTA (x)	11.3	13.5	14.7	11.0	8.8
RoE (%)	26.3	22.5	17.9	21.7	20.3
RoCE (%)	37.2	26.5	23.1	28.2	26.5

Source: Company; Sharekhan estimates

We interacted with the management of HMCL. Key highlights of the discussions are mentioned below:

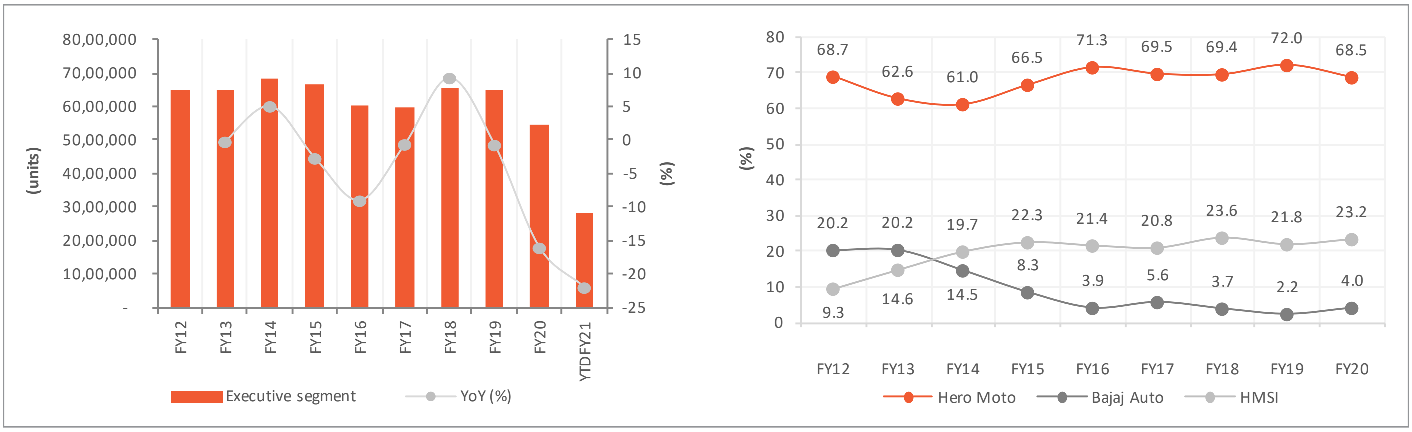
HMCL to remain the key beneficiary of 2W demand: We expect HMCL to continue its dominancy in the 2W industry, driven by its benefits from premiumisation of its products, strong foothold in the economy and executive motorcycle segments, and aggressive products offerings in the premium bikes and scooters segments. The company has kept its dominancy in the economy and executive segments despite intensifying competition in the segment due to its continuous additions of new features in existing products, successfully switching to BS-VI transition, and beneficiary of the largest distribution network.

HMCL – Key growth driver in the economy segment



Source: SIAM, Sharekhan Research

HMCL's dominancy in the executive segment remains intact despite the success of Bajaj Auto's Pulsar 125cc bike



Source: SIAM, Sharekhan Research

Aggressive launches in scooters and premium bike segments: HMCL has aggressively launched a slew of products in the scooters and premium bikes segments over the past two years. The company has launched three new models in the scooters segment over two years, viz. Destini 125, Pleasure+ 110, and Maestro Edge 125 to make its portfolio strong in the segment. Similarly, HMCL has strengthened its product portfolio in the premium bike segment by launching three products in 160cc to 200cc segments, viz. XPulse 200T, Xtreme 200S, and Xtreme 160R. In the premium bike segment, HMCL plans to launch at least one product every year over the next four years. We expect new launches will help the company build and position its brand in the medium term.

HMCL sees huge opportunity in export markets: HMCL is focusing on exports, eyeing a sizeable share in its destination markets going forward. Currently, export volumes comprise miniscule 2%-3% of its total volumes. The company has made footprints into more than 40 countries from four companies in FY2012. HMCL is exploring opportunities in few export destinations such as Colombia, Bangladesh, Nepal, Sri Lanka, and Africa. We believe exports will take time before it significantly contributes to its overall revenue.

Strategic move into EV markets: HMCL is foraying into EV markets with the changing landscape in the automobile industry. The company has invested in Ather Energy, a start-up company, taking 34.6% stake in the start-up. HMCL is also planning to launch electric 2W in FY2022. The company is open to invest into new ventures, where HMCL finds a technological edge. HMCL is well positioned to acquire or partner with new ventures in the EV space to scale businesses through its network and improve quality through its capable R&D division.

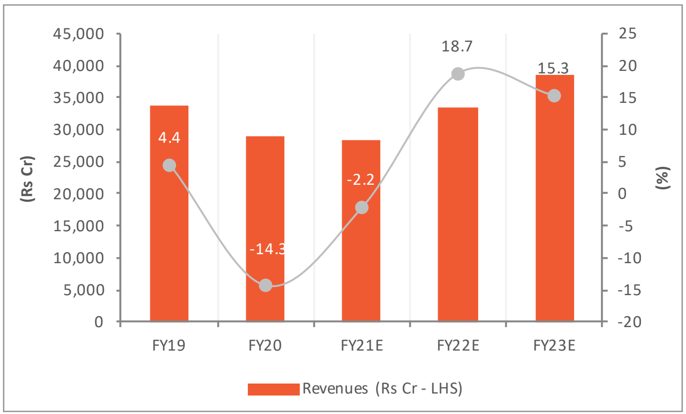
Partnership with Harley Davidson: HMCL has partnered with Harley Davidson, a global leader in the premium bike segment, to manage Harley Davidson's distribution network in India and develop smaller premium bike segments for Indian markets. HMCL will be the R&D partner for Harley Davison in India for manufacturing bikes. Partnership discussions are in the early stage and would take time to have any significant benefits.

Management guidance: The company has maintained its positive outlook for the 2W industry and expects volumes to recover post normalisation of the economy. The company expects its product portfolio to get richer and favourable, given the changing dynamics of the industry towards premiumisation. HMCL expects EBITDA margin to remain around its historical average of 14%-16%.

Strong broad-based growth; Expect double-digit growth in FY2022: The company has a strong long-term revenue visibility, given its strong positioning and leadership in economy and executive segments. We expect HMCL's earnings to grow by 17.9% in FY2022E and 15.3% in FY2023E, driven by 16.9% CAGR during FY2021E-FY2023E and 150 bps improvement in EBITDA margin.

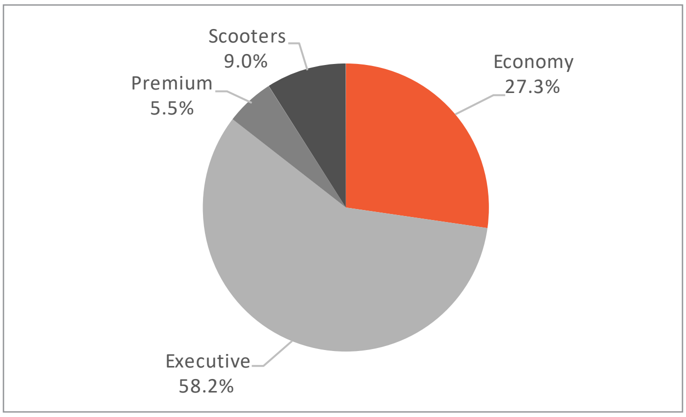
Financials in charts

Revenue and Growth Trend



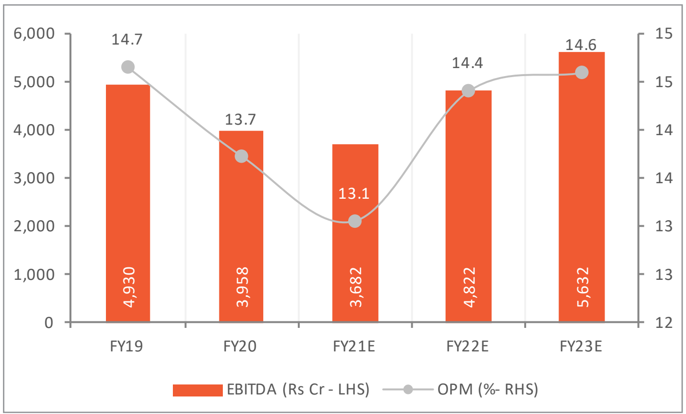
Source: Company, Sharekhan Research

Product Mix (%)



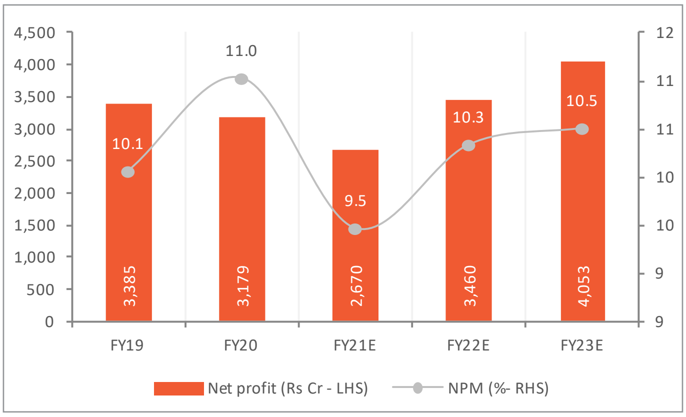
Source: Company, Sharekhan Research

EBITDA and OPM Trend



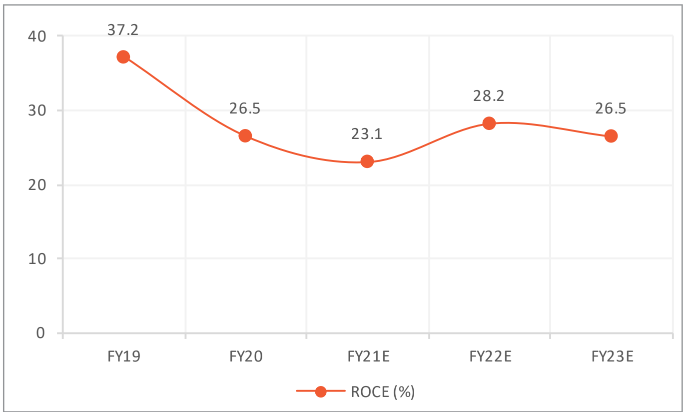
Source: Company, Sharekhan Research

Net Profit and NPM Trend



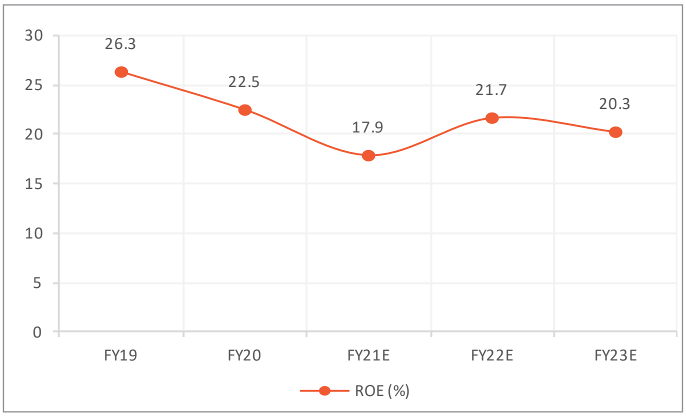
Source: Company, Sharekhan Research

ROCE Trend



Source: Company, Sharekhan Research

ROE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Demand picking up in domestic and export markets

2W demand has been improving on m-o-m basis and the trend has continued through the festive season in October-November. Recent commentary from industry leaders suggests that demand is coming even after the festive season. We expect growth momentum to continue in H2FY2021E, driven by strong rural sentiments, supported by higher kharif sowing. The government's reform measures coupled with increased preference for personal transport are expected to improve volumes. We expect strong recovery from FY2022, driven by normalisation of economic activity and pent-up demand (the industry has been in the downcycle for the past seven to eight quarters). Export markets have witnessed notable recovery in volume sales offtake across regional markets - ASEAN, South Asia, Middle East, and Africa. Indian OEMs are positive on recovery and expect these markets to improve.

■ Company Outlook – Beneficiary of 2W demand

HMCL is the market leader commanding about 38.5% market share in the 2W space. Moreover, HMCL has the highest rural exposure with rural sales contributing about half of volumes. With strong farm sentiments on account of good monsoon and higher kharif sowing, we expect HMCL to retain its leadership position. HMCL has a strong balance sheet with zero debt. The company has cash and cash equivalents worth Rs. 6,400 crore with strong return ratios. HMCL has healthy dividend pay-out ratio of 55%-65%.

■ Valuation – Maintain Buy with a revised PT of Rs. 3,496

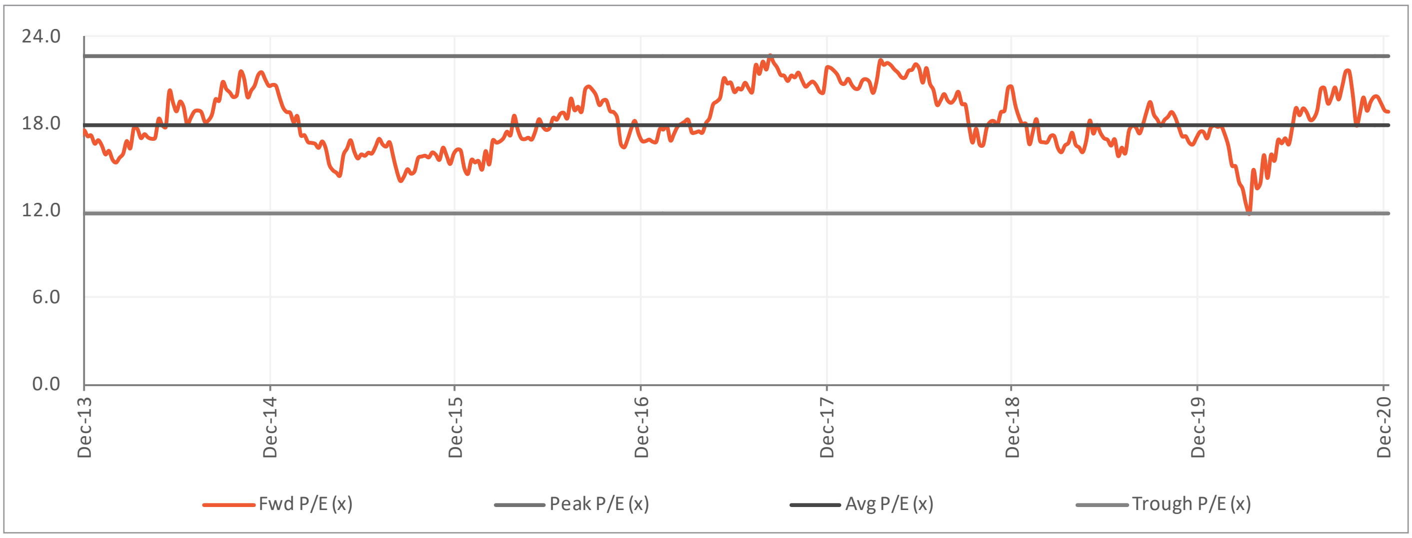
Our interaction with HMCL's management underpins our positive outlook for the 2W industry. Structural demand for 2W remains strong and will drive growth post normalisation of economic activities, owing to improving personal income, increasing penetration in the rural economy, and 2W being the most preferred mode of personal transportation. We expect the 2W industry to end FY2021 with a decline of 15.6% y-o-y against a decline of 18.3% y-o-y YTDFY2021 (April-October), followed by strong 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E. Incremental growth is likely to come from economy and executive motorcycle segments, which are slated to grow by 11% y-o-y and 10.4% y-o-y in FY2022E, respectively, driven largely by rural and tier 2 and 3 cities. We expect HMCL to be the greatest beneficiary in the sector given its leadership and largest distribution network. We have valued the stock by assigning P/E multiple of 17.2x, in-line with its average long-term P/E multiples on its FY2023E earnings to arrive at a PT of Rs. 3,496, providing an upside of 12.7% from current levels. The stock is attractively valued at P/E multiple of 15.3x and EV/EBITDA multiple of 8.8x its FY2023 estimates. We retain our Buy rating on the stock.

PT valued at Rs. 3,496

Price Target Calculation		
FY2023E EPS (Rs. per share)	203	
Target P/E Multiple (x)	17.2	At long-term average P/E multiple
Target Price (Rs.)	3,496	
Upside (%)	12.7%	

Source: Company; Sharekhan estimates

One-year forward P/E (x) band



Source: Sharekhan Research

About company

HMCL is the market leader in the 2W industry with a market share of 38.5%. HMCL is present in both the motorcycles and scooter segments, with a market share of about 51.9% and 12.4%, respectively. Motorcycles form the major chunk of revenue, contributing about 90% to volumes, while scooters contribute about 10% of volumes. HMCL is a domestically focused company deriving about 97% of its volumes from the Indian market. Entry-level motorcycles (75 cc to 110 cc) form a major chunk of about 72.5% of overall volumes.

Investment theme

HMCL is a market leader in the Indian 2W industry, commanding a ~38.5% share. The company commands ~65% market share in the economy and executive motorcycle segment, which together makes up 80% of motorcycle market size in India. HMCL has strong penetration in semi-urban and rural areas, aided by its largest distribution network in the 2W industry. We expect HMCL to be the beneficiary of rural demand and increased personal mobility. The company is also making in-roads in the premium bike segment in partnership with Harley Davidson. Operating leverage, price hikes, and cost saving under the leap programme would result in margin improvement. We expect HMCL to reach its historical margin range of 14%-16%. Hence, we retain our Buy rating on the stock.

Key Risks

- Success of rival products in the entry and executive bike segments can impact HMCL's market share in the segments.
- HMCL is aggressively expanding its product portfolio in the premium bikes segment. Unsuccessful launches in the premium segment can restrain its growth path.

Additional Data

Key management personnel

Dr. Pawan Munjal	Chairman, Managing Director and CEO
Niranjan Gupta	Chief Financial Officer
Naveen Chauhan	Head- Sales and Aftersales
Neerja Sharma	Company Secretary and Chief Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bahadur Chand Investments Pvt Ltd	20
2	MUNJAL PAWAN	13.98
3	Life Insurance Corp of India	5.24
4	Standard Life Aberdeen PLC	3.37
5	SBI Funds Management Pvt Ltd	2.99
6	Franklin Resources Inc	2.27
7	BlackRock Inc	2.24
8	Lazard Ltd	1.86
9	Vanguard Group Inc/The	1.75
10	ICICI Prudential Life Insurance Co	1.4

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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