



#### 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. 3,424	
Price Target: Rs. 4,030	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

#### Company details

Market cap:	Rs. 68,400 cr
52-week high/low:	Rs. 3,629 / 1,475
NSE volume: (No of shares)	15.6 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.0 cr

#### Shareholding (%)

Promoters	34.8
FII	35.9
DII	20.0
Others	9.4

#### Price chart



#### Price performance

(%)	1m	3m	6m	12m
Absolute	6.7	11.9	9.9	64.6
Relative to Sensex	-1.9	-2.0	-18.8	38.0

Sharekhan Research, Bloomberg

#### Summary

- We interacted with the management of Hero MotoCorp (Hero) to discuss its plans for electric two-wheelers (e-2Ws) and readiness to benefit from increasing e-2W penetration in the medium to long term.
- We believe structural growth traction in the two-wheeler (2W) industry remains intact and Hero 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.
- Hero will continue to benefit from its brand equity, due to value-for-money products, extensive service centres, low maintenance cost and higher resale value.
- The stock is valued at P/E multiple of 16.1x and EV/EBITDA multiple of 9.5x its FY2023E estimates. We retain a Buy rating on the stock.

We interacted with the management of Hero MotoCorp (Hero) to discuss its plans for electric two-wheelers (e-2Ws) and readiness to benefit from increasing e-2W penetration in the medium to long term. The company has invested in Ather Energy, a start-up company, taking a 34.6% stake. Hero is also planning to launch its own developed mass scale e-2W in FY2022. The company is open to invest into new ventures, where Hero finds a technological edge. Hero 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. The company's R&D centre in Germany will focus on primarily two products – building premium bike portfolio and developing EV products. We believe the structural growth drivers for the two-wheelers (2W) industry remains intact. Hero is expected to benefit from premiumisation of products, its stronghold in the economy and executive motorcycle segments, and aggressive products offerings in premium bike and scooters segments. Hero is a market leader in the Indian two-wheeler 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. Hero has strong reach in semi-urban and rural areas, aided by its largest distribution network in the 2W industry. We expect Hero to be the beneficiary of rural demand and the increased need for personal mobility in a post COVID-19 scenario. Hero's brand equity is because of value-for-money products, extensive service centres, low maintenance cost and higher resale value. The company has renewed focus on gaining market share in the premium bike segment and increase exports capability. Its partnership with Ather Energy and Harley Davidson will help Hero increase its presence in new technology and premium segment bikes. We expect a strong recovery in FY2022, driven by normalisation of economic activities, operating leverage, price hikes and cost-savings under the company's leap programme, which would drive up margins. We expect Hero to reach its historical margin range of 14%-16%. Hence, we retain a Buy rating on the stock.

#### Our Call

**Valuation - Maintain Buy with a PT of Rs. 4,030:** A positive outlook given by the management underpins our positive outlook for the two-wheeler industry. Structural demand for two-wheelers remains strong and will drive growth post normalisation of economic activities, owing to improving personal income, increasing penetration in the rural economy, and two-wheelers 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 16.3% y-o-y YTD FY2021, 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 tier-3 cities. We expect Hero to be the greatest beneficiary in the sector given its leadership and largest distribution network. The stock is valued at P/E multiple of 16.1x and EV/EBITDA multiple of 9.5x its FY2023E estimates. We retain a Buy rating on the stock with PT of Rs. 4,030.

#### Key Risks

Success of rival products in the entry and executive bike segments can impact Hero's market share in the segments. Moreover, if the second wave of COVID-19 intensifies, it can impact the company's sales.

#### Valuation (Standalone)

Particulars	Rs cr				
	FY19	FY20	FY21E	FY22E	FY23E
Net Sales	33,651	28,836	31,287	36,293	39,922
Growth (%)	4.4	-14.3	8.5	16.0	10.0
EBIDTA	4,930	3,958	4,135	5,266	5,875
OPM (%)	14.7	13.7	13.2	14.5	14.7
PAT	3,385	3,633	3,048	3,814	4,236
Growth (%)	-8.5	7.3	-16.1	25.1	11.1
FD EPS (Rs)	169.5	181.9	152.6	191.0	212.1
P/E (x)	20.2	18.8	22.4	17.9	16.1
P/B (x)	5.3	4.8	4.5	4.2	3.3
EV/EBIDTA (x)	12.6	15.1	14.6	11.3	9.5
RoE (%)	26.3	25.7	20.3	23.6	20.7
RoCE (%)	37.2	26.5	26.1	30.7	27.1

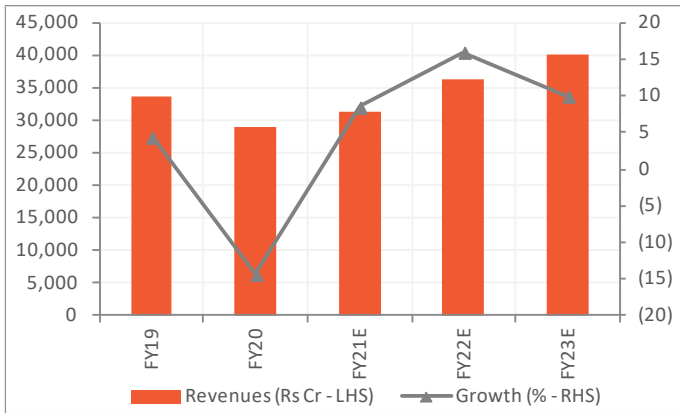
Source: Company; Sharekhan estimates

### Key highlights of the interaction with the management were as follows

- ◆ The e-scooter segment can be further categorised in two sub-segments – slow speed (i.e. <25 km/hr) technology and high speed (> 25km/hr) technology. The new entrants in e-scooter segment are generally manufacturing faster models that can run a greater distance in a single charge.
- ◆ Customers can be classified as innovators or early adopters. These customers are not price conscious but are adventurers and environment-conscious.
- ◆ The mass customers have not yet adopted to e-2Ws largely due to relatively higher price of e-2Ws as against comparable model in the ICE technology.
- ◆ The government has been continuously offering incentives and subsidies through schemes such as FAME-I and FAME-II. Despite promoting EVs, the FAME-I and FAME-II remain underutilised due to slower adoption of the e-2Ws. Further, the government has not been able to give attractive incentives to corporate.
- ◆ However, HERO has invested in Ather Energy, a start-up company, taking a 34.6% stake. Ather Energy has a market share of 11.6% in the e-2W segment. The company has not ruled out the possibility of taking majority control and greater synergies with Ather. Established in 2013, Ather Energy has been manufacturing and selling electric scooters in Bengaluru and has recently entered the Chennai market.
- ◆ Besides its investment in Ather Energy, HERO is working to develop its own product lines in e-2Ws. Hero is also planning to launch its own mass-market product (e-2W) in FY2022.
- ◆ The company is open to invest in new ventures, where Hero finds a technological edge. Hero 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. The company's R&D centre in Germany will focus on primarily two products – a premium bike portfolio and developing EV products.
- ◆ HERO is well-positioned to benefit from faster adoption in the e-2W segment.

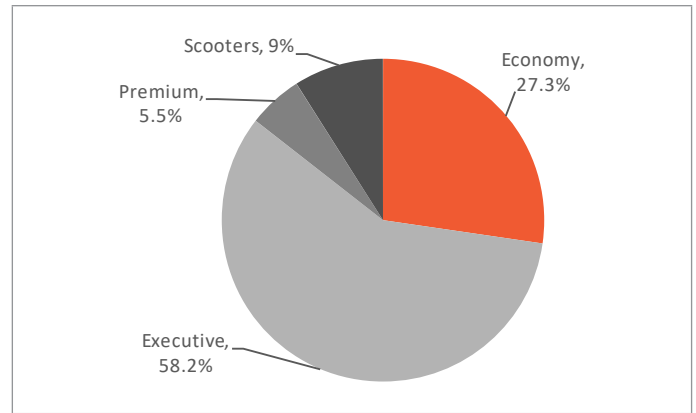
**Financials in charts**

**Revenue and Growth Trend**



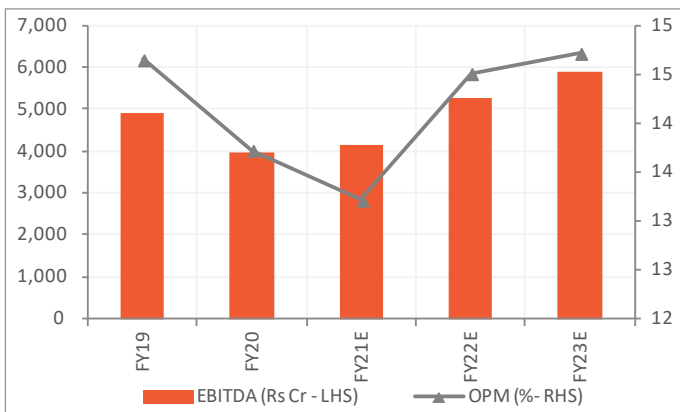
Source: Company, Sharekhan Research

**Product Mix (%)**



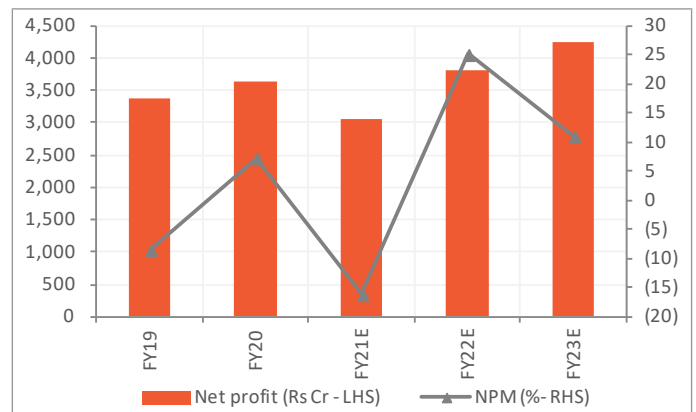
Source: Company, Sharekhan Research

**EBITDA and OPM Trend**



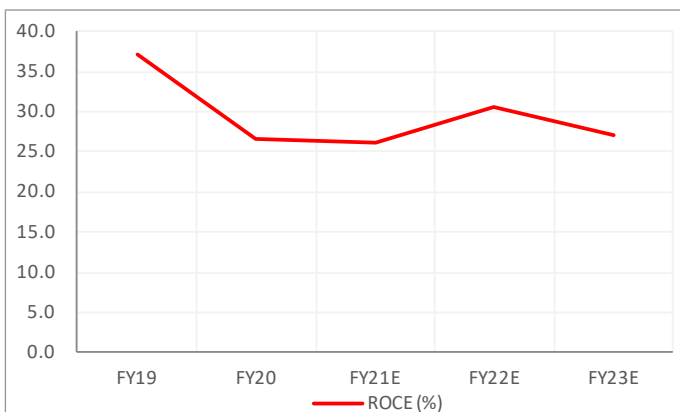
Source: Company, Sharekhan Research

**Net profit and NPM Trend**



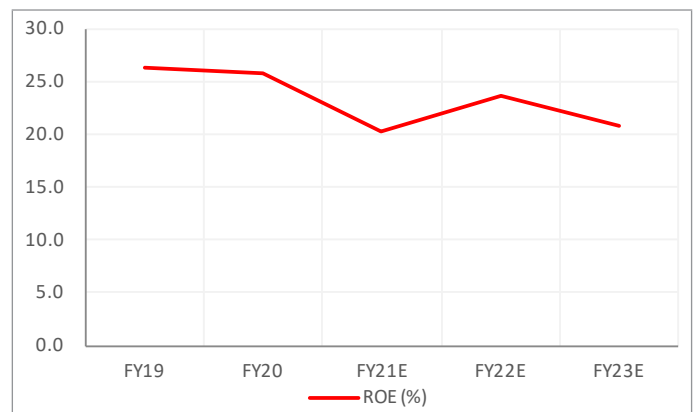
Source: Company, Sharekhan Research

**RoCE trend**



Source: Company, Sharekhan Research

**RoE trend**



Source: Company, Sharekhan Research

## Outlook and Valuation

### ■ Sector Outlook – Demand picking up in domestic and export markets

Two-wheeler demand has been improving on m-o-m basis and the trend has continued after festive seasons in October- November. 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 a strong recovery from FY2022, driven by normalisation of economic activity and pent-up demand (the industry has been in the downcycle for the past 7-8 quarters). Export markets have witnessed a 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.

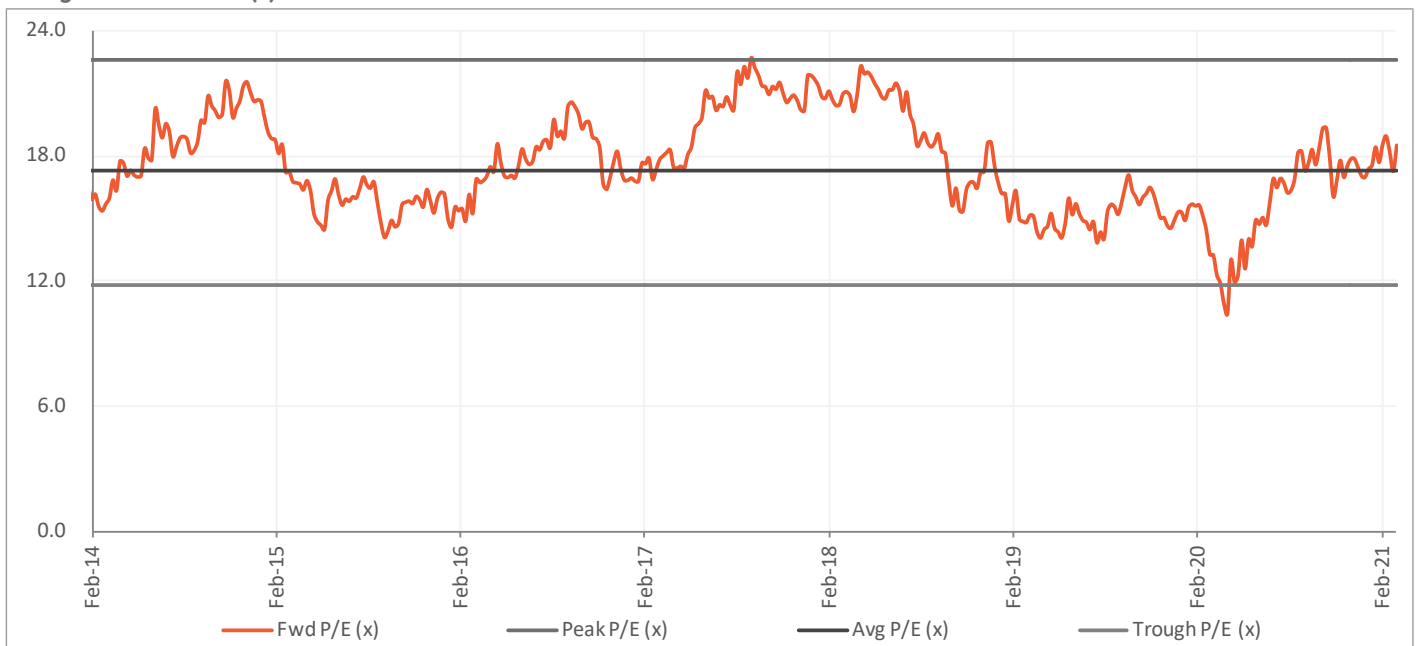
### ■ Company outlook - Beneficiary of 2W demand

Hero is the market leader commanding about 38.5% market share in the 2W space. Moreover, Hero 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 Hero to retain its leadership position. Hero has a strong balance sheet with zero debt. The company has cash and cash equivalents worth Rs. 6,400 crore with strong return ratios. Hero has a healthy dividend pay-out ratio of 55%-65%.

### ■ Valuation - Maintain Buy with a revised PT of Rs. 4,030

A positive outlook given by the management underpins our positive outlook for the two-wheeler industry. Structural demand for two-wheelers remains strong and will drive growth post normalisation of economic activities, owing to improving personal income, increasing penetration in the rural economy, and two-wheelers 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 16.3% y-o-y YTD FY2021, 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 tier-3 cities. We expect Hero to be the greatest beneficiary in the sector given its leadership and largest distribution network. The stock is valued at P/E multiple of 16.1x and EV/EBITDA multiple of 9.5x its FY2023E estimates. We retain a Buy rating on the stock with PT of Rs. 4,030.

#### One-year forward P/E (x) band



Source: Sharekhan Research

## About company

Hero is the market leader in the 2W industry with a market share of 38.5%. Hero 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. Hero 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

Hero 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. Hero has strong penetration in semi-urban and rural areas, aided by its largest distribution network in the 2W industry. We expect Hero 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 Hero 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 Hero's market share in the segments.
- ◆ Hero is expanding its product portfolio aggressively 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
Mr. Vikram S. Kasbekar	Executive Director and Chief Technical Officer
Mr. Niranjan Gupta	Chief Financial Officer
Ms. 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.	20.00%
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.	1.75%
10	ICICI Prudential Life Insurance Co.	1.40%

Source: Bloomberg

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## 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 deteriorating 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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by BNP PARIBAS

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