



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	■	↔	■

ESG Disclosure Score NEW

ESG RISK RATING
Updated Feb 08, 2021 **11.57**

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

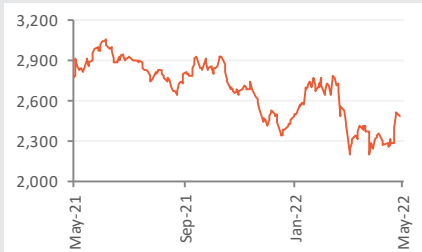
Company details

Market cap:	Rs. 49,423 cr
52-week high/low:	Rs. 3,089 / 2,148
NSE volume: (No of shares)	7.1 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.0 cr

Shareholding (%) as on December 31, 2022

Promoters	34.8
FII	29.6
DII	23.7
Others	12.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	12.6	-10.4	-9.9	-14.4
Relative to Sensex	14.3	-8.9	-3.4	-30.8

Sharekhan Research, Bloomberg

Hero MotoCorp Ltd
Margins shrink; outlook positive

Automobiles	Sharekhan code: HEROMOTOCO		
Reco/View: Buy	↔	CMP: Rs. 2,474	Price Target: Rs. 3,210
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- Q4FY22 results reported lower-than-expected EBITDA margin by 90 bps at 11.2%, due to a rise in other operating expenses.
- Hero is expected to benefit from premiumisation of its products, stronghold in the economy, executive motorcycle segments, aggressive products offerings in premium bike and scooters segments, and EV launches lined-up this year.
- Stock is trading at comfortable valuations at a P/E multiple of 13.1x and EV/EBITDA multiple of 6.7x its FY2024E estimates, with attractive dividend yield of 4.8%.
- We maintain a Buy on Hero MotoCorp Limited (Hero) with an unchanged PT of Rs. 3,210, led by expected recovery in rural, semi-urban demand and comfortable valuation.

Hero MotoCorp Limited's (Hero's) Q4FY22 results reported lower-than-expected EBITDA margin by 90 bps at 11.2%, due to sharp increase of 280 bps q-o-q in other operating expenses. Net revenues were in line with expectations, while EBITDA and PAT declined 31.7% y-o-y and 27.5% y-o-y, respectively in Q4FY22. The management has given positive guidance and expect the domestic industry to grow in double digits during FY23. April has witnessed strong demand in rural and semi urban areas ahead of festivals and marriages in Q1FY23. With the timely arrival of the monsoon season this year, we expect the rural economy to revive strongly, resulting in recovery of entry and executive level bikes. Hero is likely to be the key beneficiary due to its strong and deep-rooted distribution network. The company's management remained focus on exports and targets 15% volumes from global markets by 2025 in comparison to ~5% in FY2022. In addition, the company is well-placed to benefit from adoption of electric two-wheeler vehicles though its strong research and development (R&D), investments in Ather Energy, and strategic partnership with Taiwan-based Gogoro, a global leader in battery swapping network. We remain positive on Hero, driven by its convincing roadmap for electric vehicles (EV) penetration, focus on premiumisation, export growth opportunities, and comfortable valuations. We maintain a Buy recommendation with an unchanged price target (PT) of Rs. 3,210.

Key positives

- Average sales realisation improved 12.8% y-o-y in Q4FY22, led by price hikes and improved product mix.
- Hero's regained its market share in entry level bikes to 68.5% in Q4, as compared to ~64% in prior quarters.

Key negatives

- EBITDA margin for Q4FY22 contracted 100 bps q-o-q to 11.2%, led by 280 bps q-o-q increase other operating expenses. EBITDA and PAT was lower than estimates by 7.1% and 0.7% respectively.

Management Commentary

- April has witnessed strong demand in rural and semi urban areas ahead of festivals and marriages in Q1FY23.
- The management has given positive guidance and expect the domestic 2W industry to grow in double digits during FY23. Further, Hero expects to grow faster than the industry and increase its market share across the segments.
- Management is optimistic about the growth prospects, led by upcoming wedding season supported by good monsoon, and improving consumer confidence index.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 3,210: Positive outlook conferred by Hero's management underpins our positive outlook for the two-wheeler industry. Demand drivers for two-wheelers remain strong and will drive growth once economic activities normalise, led by improving personal incomes, increasing penetration in the rural economy and because of 2W being the most preferred mode of personal transportation amid COVID-19. We expect incremental growth in the two-wheeler industry to come from the economy and executive motorcycle segments, driven largely by rural and tier-2 and tier-3 cities. We expect Hero to be the beneficiary in the sector, given its leadership and largest distribution network. Moreover, the company's aggressive plans in scooters, premium bikes and EV segments are likely to augur well for medium-term growth. Post the 10% correction in the stock price over the past six months, the stock is trading at comfortable valuations at a P/E multiple of 13.1x and EV/EBITDA multiple of 6.7x its FY2024E estimates, with an attractive dividend yield of 3.8%. We maintain our Buy rating with an unchanged price target (PT) of Rs. 3,210.

Key Risks

Success of rival products in the entry and executive bike segments can impact Hero'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 (Standalone)

Particulars	Rs cr			
	FY21	FY22E	FY23E	FY24E
Net Sales	30,801	29,245	34,546	39,743
Growth (%)	6.8	-5.0	18.1	15.0
EBIDTA	4,019	3,369	4,271	5,170
OPM (%)	13.0	11.5	12.4	13.0
PAT	2,911	2,473	3,036	3,771
Growth (%)	-19.9	-15.1	22.7	24.2
FD EPS (Rs)	145.8	123.8	152.0	188.8
P/E (x)	17.0	20.0	16.3	13.1
P/B (x)	3.3	3.1	2.6	2.2
EV/EBIDTA (x)	10.3	12.2	9.0	6.7
RoE (%)	19.4	15.7	16.2	16.7
RoCE (%)	25.3	20.1	21.1	22.0

Source: Company; Sharekhan estimates

Q4FY22 results seen pressure on margins: Q4FY22 results reported lower-than-expected EBITDA margin by 90bps at 11.2%, due to sharp increase of 280 bps q-o-q in other operating expenses. Net revenues were in line with street expectations at Rs7,422 crore in Q4FY22, which is a decline of 14.6% y-o-y, driven by 24.3% decline in volumes, partially mitigated by a 12.8% improvement in average sales realisation. The average realisation was led by price hikes and improved product mix. EBITDA margin for Q4FY22 contracted 100 bps q-o-q to 11.2%, led by 280 bps q-o-q increase other operating expenses, partially mitigated by 170 bps q-o-q decline in raw material costs and an 8% q-o-q decline in employee costs. As a result, EBITDA and PAT for Q4FY22 declined 31.7% y-o-y and 27.5% y-o-y respectively. The EBITDA and PAT was lower than estimates by 7.1% and 0.7% respectively. The company has declared a final dividend of Rs. 35 per share (face value of Rs. 2 per equity share), aggregating to total dividend of Rs 95 per equity share for FY22.

Positive management outlook: The management is optimistic about the growth prospects, led by upcoming wedding season supported by good monsoon, and improving consumer confidence index. The management has given positive guidance and expect the domestic two-wheeler industry to grow in double-digits during FY23. Further, Hero expects to grow faster than the industry and increase its market share across the segments. The April month has witnessed strong demand recovery in the rural and semi-urban areas ahead of festivals and marriages in Q1FY23. Current inventory is ~six weeks, which is an idle inventory levels for the company, given its size and global presence.

Well-positioned to benefit from recovery in the rural economy: Hero has the strongest distribution network in the country's rural and semi-urban areas. Timely onset of the monsoon season will revive rural demand in the near future, further supported by the previous three years of a normal monsoon and positive rural sentiments. Hero is likely to be the key beneficiary due to its strong and deep-rooted distribution network in the country's rural semi-urban areas. The company is the undisputed leader in the domestic entry and executive level. BS-VI transition, input cost inflation and slower economic growth affected the buyers of entry-level bikes, which impacted the company's sales performance in the past two years.

Aggressive launches in scooters and premium bike segments: Hero 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, Hero has strengthened its product portfolio in the premium bike segment by launching three products in 160 cc to 200cc segments, viz. XPulse 200T, Xtreme 200S, and Xtreme 160R. In the premium bike segment, Hero plans to launch at least one product every year over the next four years. We expect new launches to help the company build and position its brand in the long run.

Convincing roadmap for EV product development: The management expects the EV segment to be key growth driver for the industry. Hero has taken various initiatives to strengthen its position in the emerging segment. Hero's roadmap for EV is convincing, given its preparedness and investments in technology and strategic partnerships. The company has launched Vida brand for e-mobility solutions in March 2022 and expects its first mass electric vehicle product to be unveiled in July 2022. Besides its investments in Ather Energy, the company has set up an R&D centre in Germany and Jaipur and collaborated with Taiwan start-up Gogoro. The company is working on both technologies – a fixed charging system through its own R&D and swapping technology system thorough its partner, Gogoro. Management expects actions in the EV space in the next calendar year. On the EV side, the company's own launch is expected in July 2022 and a joint development launch (swappable technology) with Gogoro is expected in CY2022.

Renewed focus on exports: Hero is focusing on exports and is eyeing a sizeable share in its destination markets going forward. Currently, export volumes comprise a miniscule 2-3% of its total volumes. The company has made footprints into more than 40 countries from four companies in FY2012. Hero is exploring opportunities in few export destinations such as Colombia, Bangladesh, Nepal, Sri Lanka, Africa, and Mexico. In Colombia, Hero has gained market share and is operating at breakeven levels. Recently, the company has partnered with a distributor in Mexico. The company's plan is to focus on the top 5-6 export destinations, where the market size is large enough. The company's management targets 15% volumes from global markets by 2025 in comparison to ~5% in FY2022E. We believe exports will take time before they significantly contribute to its overall revenue.

Results (Standalone)

Particulars	Rs cr				
	Q4FY22	Q4FY22	%YoY	Q3FY22	%QoQ
Revenue	7,422	8,686	(14.6)	7,883	(5.9)
Total operating cost	6,594	7,475	(11.8)	6,923	(4.8)
EBIDTA	828	1,211	(31.7)	960	(13.8)
Depreciation	158	163	(2.9)	164	(3.6)
Interest	7	6	5.9	7	2.3
Other Income	140	87	59.9	122	14.9
PBT	802	1,129	(29.0)	911	(11.9)
Tax	213	317	(32.9)	212	0.5
Reported PAT	627	865	(27.5)	686	(8.6)
Adjusted PAT	627	865	(27.5)	686	(8.6)
Adjusted EPS	31.4	43.3	(27.5)	34.4	(8.6)

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q4FY22	Q4FY22	YoY (bps)	Q3FY22	QoQ (bps)
Gross margin (%)	30.7	29.6	110	29.0	170
EBIDTA margin (%)	11.2	13.9	-280	12.2	-100
EBIT margin (%)	9.0	12.1	-310	10.1	-110
Net profit margin (%)	8.4	10.0	-150	8.7	-30
Effective tax rate (%)	26.5	28.1	-160	23.2	330

Source: Company; Sharekhan Research

Volume Analysis (Standalone)

Particulars	(Rs/ Vehicle)				
	Q4FY22	Q4FY22	%YoY	Q3FY22	%QoQ
Volume	11,88,884	15,69,751	(24.3)	14,38,623	(17.4)
Realization	62,426	55,333	12.8	54,797	13.9
EBITDA/Vehicle	6,961	7,716	(9.8)	6,673	4.3
RMC/Vehicle	43,254	38,970	11.0	38,887	11.2
Contribution/Vehicle	19,172	16,364	17.2	15,911	20.5
PAT/Vehicle	5,274	5,510	(4.3)	4,769	10.6

Source: Company; Sharekhan Research

Outlook and Valuation

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

We remain positive on demand for the 2W industry in the medium term and expect recovery across sub-segments after the normalisation of economic activities, led by pent-up demand from rural, semi-urban, and urban demand along with a favourable macro outlook. Two-wheeler demand is expected to remain strong amid COVID-19, as preference for personal transport and the two-wheeler segment remains the most affordable mode of transport. Rural sentiments continue to remain strong, aided by strong farming income and positive prediction for monsoon this year. 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.

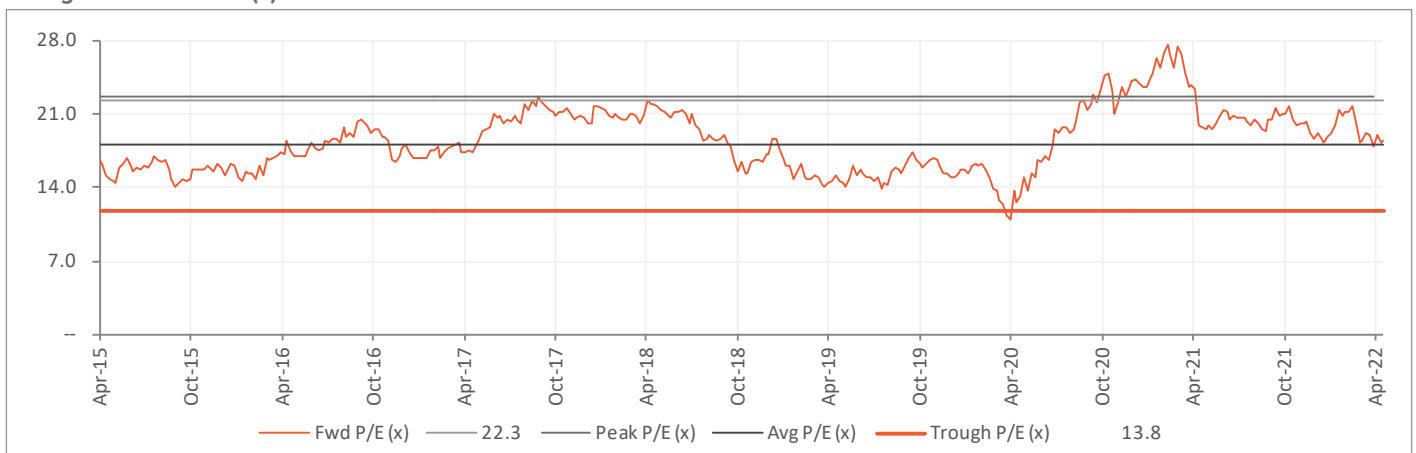
■ Company Outlook – Beneficiary of recovery in rural and semi-urban markets

Hero is the market leader commanding ~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 a 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 healthy dividend pay-out ratio of 55-65%. Hero is expected to benefit from premiumisation of its products, stronghold in the economy, executive motorcycle segments, and aggressive product offerings in the premium bike and scooters segments. In addition, the company is well positioned to benefit from the adoption of electric 2W vehicles though its strong R&D, investments in Ather Energy, and strategic partnership with Taiwan-based Gogoro, a global leader in battery swapping network. We remain positive on the company's growth prospects.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 3,210

Positive outlook conferred by Hero's management underpins our positive outlook for the two-wheeler industry. Demand drivers for two-wheelers remain strong and will drive growth once economic activities normalise, led by improving personal incomes, increasing penetration in the rural economy and because of 2W being the most preferred mode of personal transportation amid COVID-19. We expect incremental growth in the two-wheeler industry to come from the economy and executive motorcycle segments, driven largely by rural and tier-2 and tier-3 cities. We expect Hero to be the beneficiary in the sector, given its leadership and largest distribution network. Moreover, the company's aggressive plans in scooters, premium bikes and EV segments are likely to augur well for medium-term growth. Post the 10% correction in the stock price over the past six months, the stock is trading at comfortable valuations at a P/E multiple of 13.1x and EV/EBITDA multiple of 6.7x its FY2024E estimates, with an attractive dividend yield of 3.8%. We maintain our Buy rating with an unchanged price target (PT) of Rs. 3,210.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	CMP (Rs)	P/E (x)			EV/EBITDA (x)			RoCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Hero MotoCorp	2,474	17.0	20.0	16.3	10.3	12.2	9.0	25.3	20.6	21.1
Bajaj Auto	3,605	22.9	22.2	16.0	17.2	15.4	10.7	23.0	21.2	25.3
TVS Motor	652	50.6	27.5	21.9	22.8	14.8	12.1	16.2	24.7	25.8

Source: Company, Sharekhan estimates

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 make up 80% of the 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. Hero is expected to reach its historical margin of 13-16%. 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.
- ◆ Spike in COVID-19 cases may put restrictions on movement and might impact our volume estimates.

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	20.0
2	Pawan Munjal Renu Munjal & Suman Kant Munjal	14.0
3	Life Insurance Corp of India	7.4
4	LIC of India P & GS Fund	2.8
5	SBI Blue Chip Fund	1.2
6	WGI Emerging Markets Funds LLC	2.3
7	Government Pension fund Global	1.3
8	NPS Trust	1.3
9	Hero InvestCorp Private Limited	0.4
10	Pawan Munjal Family Trust	0.1

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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