



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 July 08, 2021

11.57

Low Risk

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

Source: Morningstar

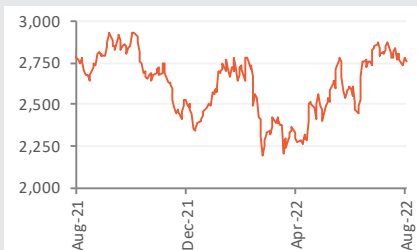
Company details

Market cap:	Rs. 55,156 cr
52-week high/low:	Rs. 2,953 / 2,148
NSE volume: (No of shares)	7.9 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.0 cr

Shareholding (%) as on Jun 30, 2022

Promoters	34.8
FII	28.8
DII	25.7
Others	10.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.0	12.7	-0.7	-2.7
Relative to Sensex	-14.3	0.1	-1.8	-12.0

Sharekhan Research, Bloomberg

Hero MotoCorp Ltd

Recovery on track. Comfortable valuations

Automobiles

Sharekhan code: HEROMOTOCO

Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 2,761

Price Target: Rs. 3,210

Summary

- We maintain a Buy on Hero MotoCorp Limited (Hero) with an unchanged PT of Rs. 3,210, led by an expected recovery in rural, semi-urban demand and comfortable valuations.
- Q1FY23 results were below expectations due to commodity headwinds and lower other incomes.
- 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 14.6x and EV/EBITDA multiple of 7.8x its FY2024E estimates, with attractive dividend yield.

Hero MotoCorp Limited's (Hero's) Q1FY23 results missed expectations due to commodity headwinds and lower other income. Net revenues, EBITDA and PAT were below expectations by 2.1%, 4.6% and 13.4% respectively. On a q-o-q basis, the revenue and EBITDA grew by 13.1% and 13.7% respectively in Q1FY23, while PAT witnessed flat growth due to MTM losses of Rs60 crore. The management has given positive guidance and expects the domestic industry to grow in double digits during FY23. During the Q2FY23, the company is witnessing strong demand in rural and semi-urban areas ahead of festivals and marriages. The retail sales have been stronger than the wholesales. With the timely arrival of the monsoon season this year, we expect the rural economy to revive strongly, resulting in the 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 focused 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 the adoption of electric two-wheeler vehicles through 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 premiumization, export growth opportunities, and comfortable valuations. We maintain a Buy recommendation with an unchanged price target (PT) of Rs. 3,210.

Key positives

- Hero's continues to gain market shares across the sub-segments during Q1FY23, viz., economy bike segment up 210bps q-o-q to 63.3%, executive bike segments up by 110bps q-o-q to 66.1%, premium bike segments up by 30bps q-o-q to 3.7% and scooter segment by 60bps to 6.7%.
- EBITDA margin were maintained sequentially at 11.2% in Q1FY23 through cost savings and rationalization, despite significant commodity headwinds.

Key negatives

- Gross margins declined 350bps q-o-q to 27.2% in Q1FY23, impacted adversely by product mix and commodity price inflation.
- Chips shortage continued to impact sales of selected products in the quarter.

Management Commentary

- During the Q2FY23, the company is witnessing strong demand in rural and semi-urban areas ahead of festivals and marriages. The retail sales have been stronger than the wholesales.
- The management has maintained positive guidance and expects 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 the upcoming wedding season supported by good monsoon, and improving consumer confidence index.
- Company's e-2W is expected to be launched during the festive season.

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 normalize, led by improving personal incomes, increasing penetration in the rural economy and because of 2W is 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 for scooters, premium bikes, and EV segments are likely to augur well for medium-term growth. The stock is trading at comfortable valuations at a P/E multiple of 14.6x and EV/EBITDA multiples of 7.8x its FY2024E estimates, with an attractive dividend yield. We maintain our Buy rating with an unchanged price target (PT) of Rs. 3,210.

Key Risks

The 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	FY21	FY22	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)	18.9	22.3	18.2	14.6
P/B (x)	3.7	3.5	2.9	2.4
EV/EBIDTA (x)	11.8	13.9	10.3	7.8
RoE (%)	19.4	15.7	16.2	16.7
RoCE (%)	25.3	20.1	21.1	22.0

Source: Company; Sharekhan estimates

Q1FY23 results seen pressure on margins: Q1FY23 results missed expectations due to commodity headwinds and lower other income. Net revenues, EBITDA, and PAT were below expectations by 2.1%, 4.6% and 13.4% respectively. On a q-o-q basis, the revenue and EBITDA grew by 13.1% and 13.7% respectively in Q1FY23, while PAT witnessed flat growth due to MTM losses of Rs60 crore. Net revenues were up 13.1% q-o-q to Rs8,393 crore in Q1FY23, led by 16.9% growth in volumes, partially offset by a 3.3% decline in average realization. The average realization is impacted by product mix. EBITDA margins were maintained sequentially at 11.2% in Q1FY23 through cost savings and rationalization, despite significant commodity headwinds. Gross margins declined 350bps q-o-q to 27.2% in Q1FY23, impacted adversely by product mix and commodity price inflation. As a result, EBITDA was up 13.7% q-o-q to Rs941 crore. PAT growth was flat, led by lower other income due to MTM losses.

Positive management outlook: The management is optimistic about the growth prospects, led by the upcoming wedding season supported by a good monsoon, and an improving consumer confidence index. The management has given positive guidance and expects 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. During the Q2FY23, the company is witnessing strong demand in rural and semi-urban areas ahead of festivals and marriages. The retail sales have been stronger than the wholesales.

Well-positioned to benefit from the recovery in the rural economy: Hero has the strongest distribution network in the country's rural and semi-urban areas. The 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 bike 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 launched the Vida brand for e-mobility solutions in March 2022 and expects its first mass electric vehicle product to be unveiled during the coming festive season. 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 a swapping technology system through 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 minuscule 2-3% of its total volumes. The company has made footprints in more than 40 countries from four companies in FY2012. Hero is exploring opportunities in a 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	Q1FY23	Q1FY22	%YoY	Q4FY22	%QoQ
Revenue	8,393	5,487	53.0	7,422	13.1
Total operating cost	7,452	4,972	49.9	6,594	13.0
EBIDTA	941	515	82.7	828	13.7
Depreciation	163	163	0.0	158	2.9
Interest	7	6	14.6	7	4.8
Other Income	53	139	(61.8)	140	(62.1)
PBT	824	484	70.1	802	2.7
Tax	184	118	56.3	213	(13.4)
Reported PAT	625	365	70.9	627	(0.4)
Adjusted PAT	625	365	70.9	627	(0.4)
Adjusted EPS	31.3	18.3	70.9	31.4	(0.4)

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q1FY23	Q1FY22	YoY (bps)	Q4FY22	QoQ (bps)
Gross margin (%)	27.2	27.5	(20)	30.7	(350)
EBIDTA margin (%)	11.2	9.4	180	11.2	10
EBIT margin (%)	9.3	6.4	290	9.0	30
Net profit margin (%)	7.4	6.7	80	8.4	(100)
Effective tax rate (%)	22.3	24.3	(200)	26.5	(420)

Source: Company; Sharekhan Research

Volume Analysis (Standalone)

Particulars	Q1FY23	Q1FY22	%YoY	Q4FY22	%QoQ
Volume	13,90,193	10,24,489	35.7	11,88,884	16.9
Realization	60,370	53,559	12.7	62,426	(3.3)
EBITDA/Vehicle	6,767	5,025	34.7	6,961	(2.8)
RMC/Vehicle	43,932	38,845	13.1	43,254	1.6
Contribution/Vehicle	16,438	14,714	11.7	19,172	(14.3)
PAT/Vehicle	4,492	3,567	25.9	5,274	(14.8)

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 favorable macro outlook. Two-wheeler demand is expected to remain strong amid COVID-19, as a 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.

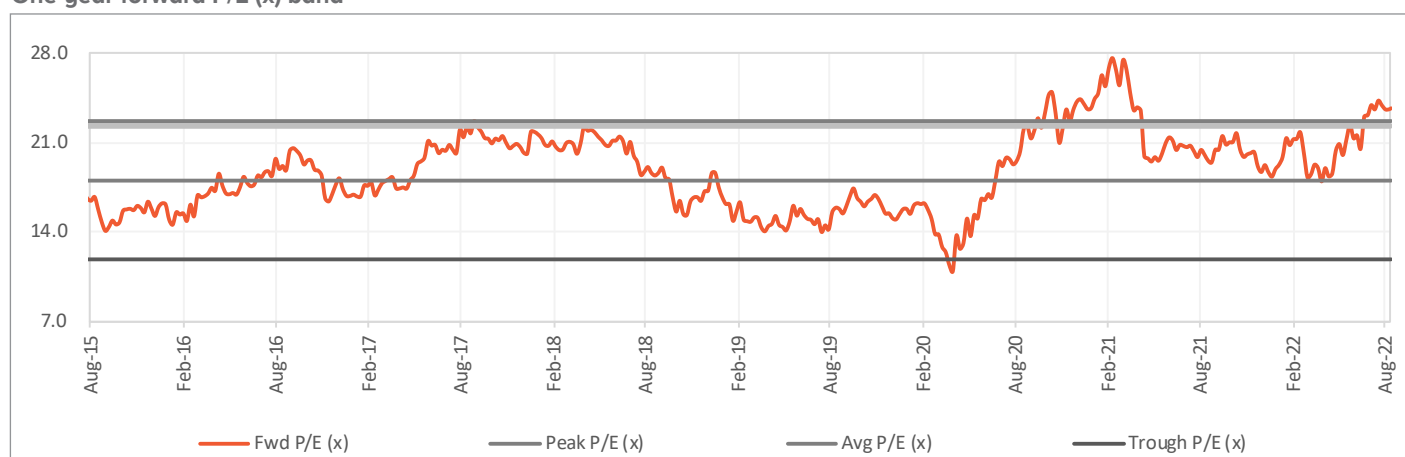
■ Company Outlook – Beneficiary of recovery in rural and semi-urban markets

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 volume. With strong farm sentiments on account of a good monsoon and higher crop production, 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 crores with strong return ratios. Hero has a healthy dividend pay-out ratio of 55-65%. Hero is expected to benefit from premiumization 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 through 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

The 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 normalize, 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. The stock is trading at comfortable valuations at a P/E multiple of 14.6x and EV/EBITDA multiples of 7.8x its FY2024E estimates, with an attractive dividend yield. 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 (%)		
		FY22	FY23E	FY24E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Hero MotoCorp	2,761	22.3	18.2	14.6	13.9	10.3	7.8	20.1	21.1	22.0
Bajaj Auto	4,036	24.8	17.9	16.1	17.8	12.4	10.7	21.2	25.3	25.8
TVS Motor	953	49.0	30.1	24.3	23.5	16.9	13.7	21.3	27.8	28.8

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 program 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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