Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 11.57

Updated Aug 08, 2021

Low Risk

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

Source: Morningstar

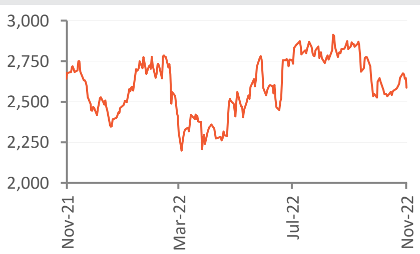
Company details

Market cap:	Rs. 51,700 cr
52-week high/low:	Rs. 2,939 / 2,148
NSE volume: (No of shares)	6.6 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.0 cr

Shareholding (%)

Promoters	34.8
FII	27.8
DII	26.9
Others	10.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.5	-8.9	2.8	-2.7
Relative to Sensex	-4.9	-13.8	-3.2	-5.5

Sharekhan Research, Bloomberg

Hero MotoCorp Ltd

Demand firms up

Automobiles	Sharekhan code: HEROMOTOCO
Reco/View: Buy ↔	CMP: Rs. 2,588 · Price Target: Rs. 3,210 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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.
- Q2FY23 results were broadly in-line with expectations with rural demand showing recovery during the festive season.
- 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 13.7x and EV/EBITDA multiple of 7.2x its FY2024E estimates, with attractive dividend yield.

Q2FY23 results were broadly in-line with expectations. Net revenues stood at Rs9,075 crore in Q2FY23, showing a growth of 7.4% y-o-y, aided by 8.1% growth in average realisation, partially offset by a decline of 0.7% in volumes. EBITDA margin expanded 20bps q-o-q to 11.4%, led by improved product mix and operating leverage benefits, partially offset by higher marketing expenses. The management is optimistic about the rural demand recovery witnessed during the festive season. The company expects the next marriage season to witness strong retail sales, which is in the months of February and March 2023. In respect of the forthcoming winter crop season and Rabi seasons, 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 networks. 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

- Gross margins improved 80bps q-o-q to 28%, led by improved product mix and operating leverage benefits, while higher marketing expenses led to only 20bps q-o-q improvement in EBITDA margin at 11.4%.
- Retail sales during the 32-day festive season improved 20% y-o-y as compared previous year. The retail sales also indicate 95% of pre-COVID volumes this year.

Key negatives

- Gross margins declined 350bps q-o-q to 27.2% in Q2FY23, impacted adversely by product mix and commodity price inflation.
- Chips shortage continued to impact sales of selected products in the quarter.

Management Commentary

- During Q2FY23, the company's management is optimistic about the rural demand recovery witnessed during the festive season. The company expects the next marriage season to witness strong retails sales, which is in the months of February and March, 2023. 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 a good monsoon, and an 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 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 13.7x and EV/EBITDA multiples of 7.2x 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) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	30,801	29,245	34,546	39,743	43,724
Growth (%)	6.8	-5.0	18.1	15.0	10.0
EBIDTA	4,019	3,369	4,271	5,170	5,759
OPM (%)	13.0	11.5	12.4	13.0	13.2
PAT	2,911	2,473	3,036	3,771	4,257
Growth (%)	-19.9	-15.1	22.7	24.2	12.9
FD EPS (Rs)	145.8	123.8	152.0	188.8	213.2
P/E (x)	17.8	20.9	17.0	13.7	12.1
P/B (x)	3.4	3.3	2.8	2.3	1.9
EV/EBIDTA (x)	10.9	12.9	9.5	7.2	5.7
RoE (%)	19.4	15.7	16.2	16.7	15.9
RoCE (%)	25.3	20.1	21.1	22.0	20.9

Source: Company; Sharekhan estimates

Key Conference call takeaways

- **Q2FY23 results were in-line with expectations:** Q2FY23 results were broadly in-line with expectations. Net revenues stood at Rs9,075 crore in Q2FY23, showing a growth of 7.4% y-o-y, aided by 8.1% growth in average realisation, partially offset by a decline of 0.7% in volumes. The average realisation was led by price hikes and improved product mix. Gross margins improved 80bps q-o-q to 28%, led by improved product mix and operating leverage benefits, while higher marketing expenses led to only 20bps q-o-q improvement in EBITDA margin at 11.4%. As a result, EBITDA and PAT for Q1FY23 declined 2.6% y-o-y and 9.9% y-o-y respectively.
- **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. Management is optimistic about the rural demand recovery witnessed during the festive season. The company expects the next marriage season to witness strong retails sales, which is in the months of February and March, 2023.
- **Strong retail sales during Q2:** The festive season witnessed comeback of rural customers during peak Dusshera-Diwali festivals, that led to 20% increase in retail sales during the 32-day festive season in FY23 as compared to the festive season in FY22. The retail sales also indicate 95% of pre-COVID volumes this year. Inventories are lower at dealers' end against normal inventory levels of 4-6 weeks. Better financing availability, incentives, discounts and new launches were the key contributors to sales, besides the recovery witnessed in rural demand.
- **Recovery witnessed in its key product lines:** The company witnessed recovery in its sales of Passion, Splendor and Splendor plus during the quarter. The company has seen market share recovery in the 125cc segment, which is a source of growth factor from both up-graders from 110cc segment and down-graders from 150cc segment. The retail segment of 125cc products saw a double-digit growth rate during the Q2FY23. The Xtech variants have got a strong response from customers, aided by premiumisation trend.
- **EV business:** The newly launched Vida is moving as per the schedule. The Vida V1 is premium e-scooters, which has a considerable 32% share in EV scooter industry. The company has plans to launch affordable e-scooters as the next launch in the EV pipeline. New launches would help to increase the company's addressable market by another 20%. The company continues to invest in Ather Energy, which is doing well in the markets. There has been a minute dilution in the company's stake in the Ather Energy, due to GIC's investment of Rs400 crore in Ather. The company remain fully committed to work together with Ather. The partnership with Gogoro remains fully intact and both companies will continue to work jointly going forward.
- **Premium bike segment:** The company is in advance stage to launch its premium products in the markets, with the collaboration of Harley Davidson. The company management expects to launch a new premium model every year.
- **Chips shortage easing:** The company has managed well the situation of ECU shortage during the festive season and was able to improve product mix, where the use of ECUs was higher.
- **Hero Fincorp:** Hero Fincorp's performance has improved in Q2FY23, led by growth in profits. The gross NPA has declined during Q2, while AUM has improved in double digits
- **Convincing roadmap for EV product development:** The management expects the EV segment to be the 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 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) Rs cr

Particulars	Q2FY23	Q2FY22	%YoY	Q1FY23	%QoQ
Revenue	9,075	8,453	7.4	8,393	8.1
Total operating cost	8,037	7,387	8.8	7,452	7.9
EBIDTA	1,038	1,066	(2.6)	941	10.4
Depreciation	163	164	(0.3)	163	0.2
Interest	3	7	(49.4)	7	(52.6)
Other Income	92	157	(41.3)	53	73.7
PBT	964	1,053	(8.5)	824	17.0
Tax	227	256	(11.5)	184	23.1
Reported PAT	716	794	(9.9)	625	14.7
Adjusted PAT	716	794	(9.9)	625	14.7
Adjusted EPS	35.8	39.8	(9.9)	31.3	14.6

Source: Company; Sharekhan Research

Key ratios (Standalone)

Particulars	Q2FY23	Q2FY22	YoY (bps)	Q1FY23	QoQ (bps)
Gross margin (%)	28.0	27.7	30	27.2	80
EBIDTA margin (%)	11.4	12.6	(120)	11.2	20
EBIT margin (%)	9.6	10.7	(100)	9.3	40
Net profit margin (%)	7.9	9.4	(150)	7.4	40
Effective tax rate (%)	23.5	24.3	(80)	22.3	120

Source: Company; Sharekhan Research

Volume Analysis (Standalone) (Rs/ Vehicle)

Particulars	Q2FY23	Q2FY22	%YoY	Q1FY23	%QoQ
Volume	14,28,168	14,38,623	(0.7)	13,90,193	2.7
Realization	63,545	58,760	8.1	60,370	5.3
EBITDA/Vehicle	7,270	7,412	(1.9)	6,767	7.4
RMC/Vehicle	45,724	42,474	7.7	43,932	4.1
Contribution/Vehicle	17,822	16,287	9.4	16,438	8.4
PAT/Vehicle	5,014	5,522	(9.2)	4,492	11.6

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 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 predictions for monsoon this year. Export markets have witnessed a notable recovery in volume sales offtake across regional markets – ASEAN, South Asia, the Middle East, and Africa. Indian OEMs are positive on recovery and expect these markets to improve.

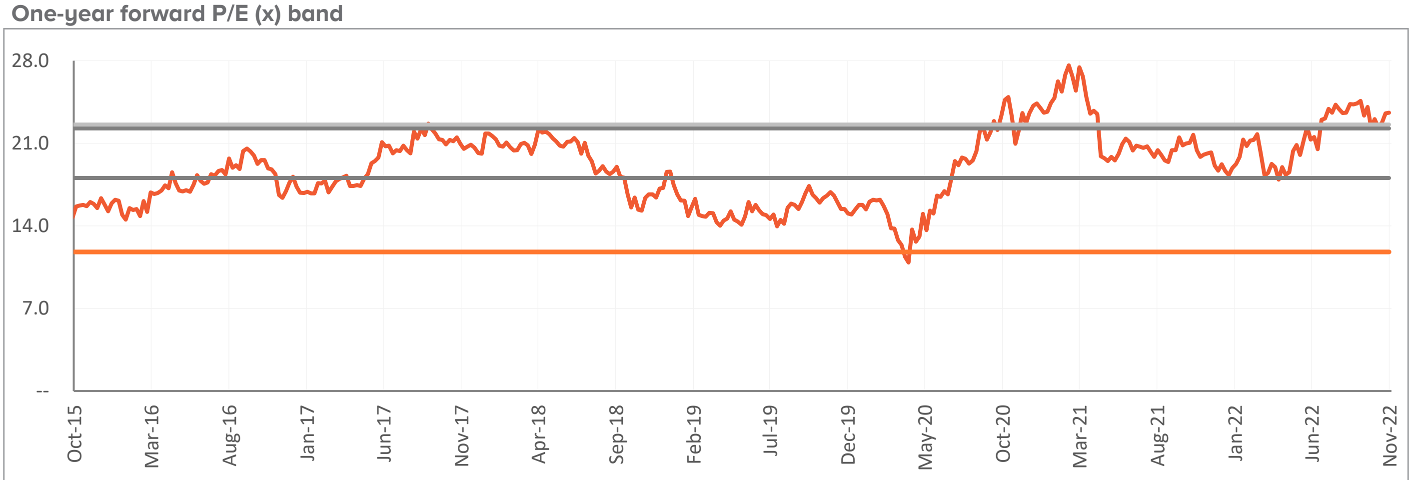
Company Outlook – Beneficiary of recovery in rural and semi-urban markets

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 the 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 the premiumization of its products, stronghold in the economy, executive motorcycle segments, and aggressive product offerings in the premium bike and scooter 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

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 13.7x and EV/EBITDA multiples of 7.2x 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 valuation

Company	CMP (Rs / Share)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY22	FY23E	FY24E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Hero MotoCorp	2,588	20.9	17.0	13.7	12.9	9.5	7.2	20.1	21.1	22.0
Bajaj Auto	3,771	23.2	19.8	16.8	16.3	13.3	10.8	21.2	21.7	23.7
Eicher Motors	3,664	59.7	35.1	27.1	45.6	28.7	23.7	14.1	20.7	22.1

Source: Company, 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 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

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

Sharekhan

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