Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Hero MotoCorp Ltd

Betting on Rural recovery

Automobiles	Sharekhan code: HEROMOTOCO
Reco/View: Buy ↔	CMP: **Rs. 2,613**
	Price Target: **Rs. 3,006** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Stock Update

Result 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		↔	

ESG Disclosure Score NEW

ESG RISK RATING	11.43
Updated Dec 08, 2022	

Low Risk

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

Source: Morningstar

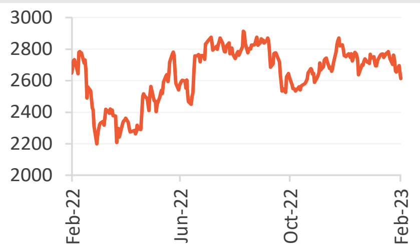
Company details

Market cap:	Rs. 52,199 cr
52-week high/low:	Rs. 2,939 / 2,148
NSE volume: (No of shares)	5.07 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.0 cr

Shareholding (%)

Promoters	34.8
FII	27.5
DII	27.3
Others	10.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.7	-1.5	-8.0	-6.0
Relative to Sensex	-6.0	-0.8	-12.4	-9.2

Sharekhan Research, Bloomberg

Summary

- We maintain Buy on stock with downward revised target price of Rs 3,006 and believe that rural recovery is key for outperformance from here. Stock trades at P/E of 13.5x and EV/EBIDTA of 6.6x its Fy2025 estimates.
- Operating performance was inline as EV business has impacted blended EBIDTA margin by 70 bps, else IC business performed well at operating front.
- HMCL aims to surpass two-wheeler industry's revenue growth in FY24 led by its leadership position and improved product mix.
- Post successful launch of premium electric scooter VIDA in 3 cities, HMCL plans to expand EV product portfolio in coming years.

In Q3FY2023, Hero MotoCorp (HMCL) reported operating performance in line with estimates and PAT above estimates on account of higher-than-expected other income. Albeit the EBITDA margin has improved substantially in exiting business but the entry in the EV space has dragged the blended EBIDTA margin. Given that post-festive season HMCL under dealer inventory control and hence wholesale volumes declined by 13.2% q-o-q, resulted in 11.5% q-o-q decline in revenue to Rs 8,031 crore (against our estimate of Rs 8,045 crore) and EBITDA declined by 11% q-o-q to Rs 924 crore (against our estimate of Rs 941 crore). The benefit of soft commodity cost was partly offset by absence of operating leverage and cash burn in EV business. Gross margin expanded by 250 bps q-o-q but EBIDTA margin expanded by mere 10 bps q-o-q to 11.5% (against the expectation of 11.7%). The company has introduced brand VIDA in October and entered in Delhi, Jaipur and Bangalore market. The low-volume EV business has dragged the EBIDTA margin by 70 bps else the IC business has registered an EBITDA margin at 12.2%. While the newly launched EV business has dragged its operating performance in Q3FY2023 the management believes that economics of scale in EV business and improvement in operating performance of ICs business would help it report better operating performance going forward. The management aims to expand its market share in the domestic market via launching new products in multiple segments in the coming period and side-by-side planning to expand its EV product portfolio in the medium term. HMCL has announced an interim dividend of Rs 65/ share. The management is optimistic about the rural demand recovery due to the ongoing marriage season. We maintain a Buy recommendation with a revised price target (PT) of Rs. 3,006.

Key positives

- Gross margins improved 250 bps q-o-q to 30% and gross profit increased by 11.2% q-o-q to Rs 19,817 per unit, led by judicious price hikes and soft commodity cost.
- The company has entered EV space via premium scooter brand VIDA and launched electric scooters in 3 major cities in India.
- Other income increased by 99.0% q-o-q to Rs 183 crore as it was recording MTM losses in previous quarters and hence registered flat PAT on q-o-q basis despite 11% q-o-q decline in EBITDA.

Key negatives

- EV business dragged EBITDA margin by 70 bps
- The volume growth trend is still weak in rural areas compared to urban areas.

Management Commentary

- In Fy2024, the two-wheeler industry would register double-digit revenue growth, and HMCL targets to outperform the industry in FY2024
- Management is optimistic about the growth prospects, led by the upcoming wedding season supported by a good rabi crop season
- Soft raw material cost trend along with a better product mix would translate into better operating performance in the coming period
- HMCL would strengthen its market position in the domestic market by launching new products in the premium segment.

Our Call

Valuation - Maintain Buy with an revised PT of Rs. 3,006: Post reporting in line with estimated performance in Q3FY2023, the management shared its optimistic outlook for the near-term on the expectation of recovery in rural sales due to the ongoing festive season and targets to outperform the industry revenue growth in FY2024 backed by its new product launch strategy, recovery in replacement demand and successful acceptance of its EV products in the market. Though the favourable raw material price trend would augur well for the EBITDA margin expansion in the ICs business the low-volume cash-burning EV business would limit the blended EBITDA margin expansion till EV business scale up at breakeven levels. Demand drivers for two-wheelers remain strong and will drive growth once economic activities normalise, led by improving personal incomes and increasing penetration in the rural economy 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 will likely augur well for medium-term growth. The stock is trading at a P/E multiple of 13.5x and EV/EBITDA multiples of 6.6x its FY2025E estimates; we maintain our Buy rating with a downward revised price target (PT) of Rs. 3,006.

Key Risks

The success of rival products in the entry and executive bike segments can impact Hero's market share. The company is aggressively expanding its product portfolio in the premium bikes segment as well as in EV space. Unsuccessful launches in the premium segment or in EV segment can restrain its growth path.

Valuation Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	30801	29245	33273	37494	41196
Growth (%)	6.8	-5.0	13.8	12.7	9.9
EBIDTA	4019	3369	3813	4745	5282
OPM (%)	13.0	11.5	11.5	12.7	12.8
PAT	2911	2473	2698	3430	3874
Growth (%)	-19.9	-15.1	9.1	27.1	12.9
FD EPS (Rs)	145.8	123.8	135.1	171.7	194.0
P/E (x)	17.9	21.1	19.3	15.2	13.5
P/B (x)	3.5	3.3	2.8	2.4	2.0
EV/EBIDTA (x)	11.0	13.0	10.9	8.1	6.6
RoE (%)	19.4	15.7	14.6	15.7	15.0
RoCE (%)	25.3	20.1	19.3	20.7	19.9

Source: Company; Sharekhan estimates

Key takeaways from the conference call

Favourable raw material cost trend: HMCL has registered a 160-bps y-o-y expansion in gross margin led by 150-200 bps correction in commodity cost and judicious price hikes. Given that HMCL has been taking commensurate price hikes the gross revenue per unit has increased by 11.2% q-o-q. Recently HMCL has increased prices by Rs 930/ unit in December 2022. Going forward, the management assumes that the commodity cost trend will remain soft and hence would limit the need to increase prices. This would stabilise the prices of the product in the market and drive the demand and profitability simultaneously. The implementation of BSVI phase 2 would have minimal impact on pricing as prices are expected to go up by Rs 500-Rs800/ unit due to the launch of new emission norms.

Aims to prosper in EV space: Post launching the premium electric scooter – VIDA in 3 cities (Jaipur, Delhi and Bangalore), the company is aiming to expand its EV network expansion in the coming months and plan to launch multiple products in different segments. The outstanding order book for VIDA stood at 5,300 units. Though the EV business is expected to impact its profitability in the initial phase, but the management expects an improvement in profitability from the EV segment once the volume ramp up. In Q3Fy2023 the EV business impacted HMCL's EBIDTA margin by 70 bps. Beyond launching electric scooter HMCL is also setting up charging stations. It has already set up 15 charging stations in Jaipur and 18 charging stations in Bangalore.

New product launch would strengthen its leadership: HMCL is aiming to strengthen its position in the 125-cc segment and scooter segment and hence planning to launch multiple products in the coming years. Beyond that, it has been enhancing value for the customers via launching XTEC versions in its established products which offers premium features and asks for a higher price in the market. Beyond tha,t HMCL has been improving its channel networks to attract new set of customers and to expand its market share in the domestic market.

Optimistic Outlook: In the near term the vehicle demand is expected to improve due to ongoing festive season and the expectation of better realisation from rabi crop. While the rural segment and entry-level motorcycle segment has yet to recover HMCL assumes a double-digit revenue growth in two-wheeler industry for FY2024 and targets to outperform the industry led by improvement in product mix via focussing on 125 cc segment and expectation of recovery in two-wheeler volumes. The company is focussing on premiumization of its product portfolio and looking for a 10% of revenue to come from export markets in the medium term. The softening of commodity prices and adequate price hike along with rise in demand would help HMCL register better margins in the coming period.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY %	Q2FY23	QoQ %
Revenue	8,031	7,883	1.9	9,075	(11.5)
Total operating cost	7,107	6,923	2.7	8,037	(11.6)
EBIDTA	924	960	(3.7)	1,038	(11.0)
Depreciation	162	164	(1.5)	163	(0.9)
Interest	5	7	(24.7)	3	48.0
Other Income	183	122	50.6	92	99.0
PBT	940	911	3.3	964	(2.4)
Tax	236	212	11.4	227	4.0
Reported PAT	711	686	3.6	716	(0.7)
Adjusted PAT	711	686	3.6	716	(0.7)
Adjusted EPS	35.6	34.4	3.6	35.8	(0.7)

Source: Company, Sharekhan Research

Key ratios (Standalone)

Particulars	Q3FY23	Q3FY22	YoY (bps)	Q2FY23	QoQ (bps)
Gross margin (%)	30.6	29.0	160	28.0	250
EBIDTA margin (%)	11.5	12.2	(70)	11.4	10
Net profit margin (%)	8.9	8.7	20	7.9	100
Effective tax rate (%)	25.1	23.2	180	23.5	160

Source: Company, Sharekhan Research

Volume Analysis (Standalone) **(Rs. per Vehicle)**

Particulars	Q3FY23	Q3FY22	YoY (bps)	Q2FY23	QoQ (bps)
Volume	12,39,693	12,92,136	(4.1)	14,28,168	(13.2)
Realization	64,782	61,010	6.2	63,545	1.9
EBITDA/Vehicle	7,455	7,430	0.3	7,270	2.5
RMC/Vehicle	44,965	43,295	3.9	45,724	(1.7)
Contribution/Vehicle	19,817	17,714	11.9	17,822	11.2
PAT/Vehicle	5,736	5,310	8.0	5,014	14.4

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. We 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 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.

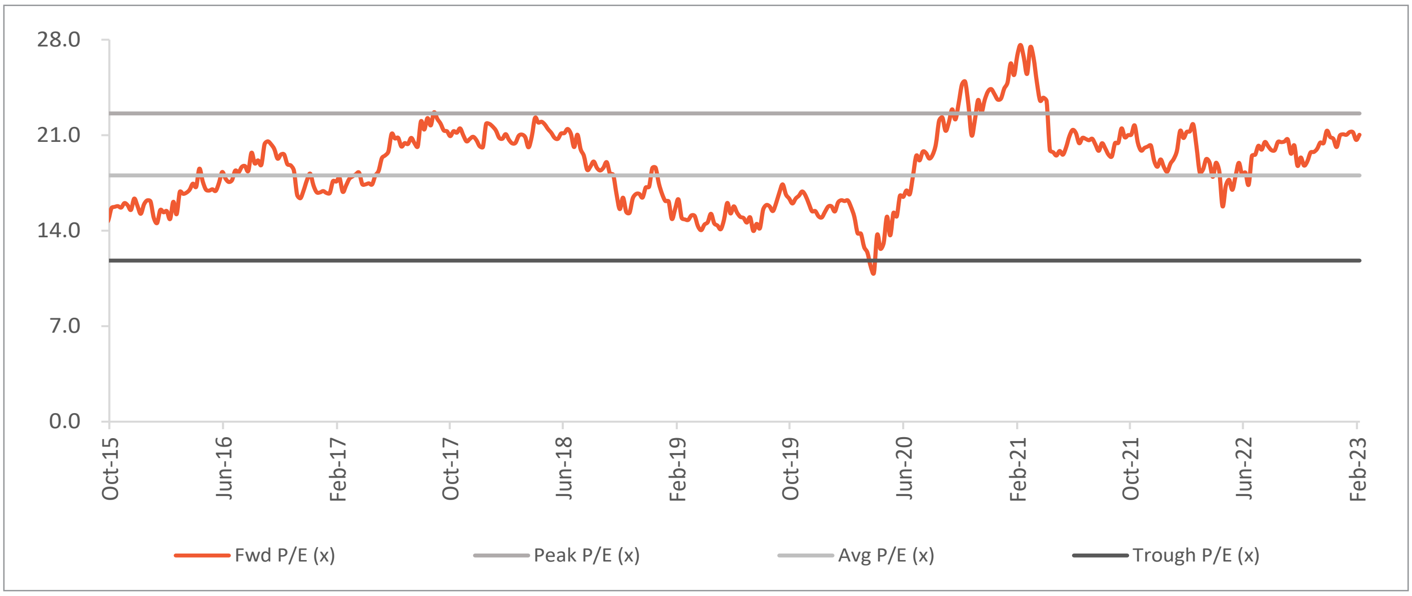
■ Company outlook - Beneficiary of recovery in rural and semi-urban markets

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 net cash. Hero has a healthy dividend pay-out ratio of 55-65%. Hero is expected to benefit from the premiumisation 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 adopting 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 networks. We remain positive on the company's growth prospects.

■ Valuation - Maintain Buy with a revised PT of Rs. 3,006:

Post reporting in line with estimated performance in Q3FY2023 the management shared its optimistic outlook for near term on the expectation of recovery in rural sales due to ongoing festive season and targets to outperform the industry revenue growth in FY2024 backed by its new product launch strategy, recovery in replacement demand and successful acceptance of its EV products in the market. Though the favourable raw material price trend would augur well for the EBITDA margin expansion in ICs business the low-volume cash-burning EV business would limit the blended EBITDA margin expansion till EV business scale up at breakeven levels. Demand drivers for two-wheelers remain strong and will drive growth once economic activities normalise, led by improving personal incomes and increasing penetration in the rural economy 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 a P/E multiple of 13.5x and EV/EBITDA multiples of 6.6x its FY2025E estimates, we maintain our Buy rating with a downward revised price target (PT) of Rs. 3,006.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs/ Share)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY22	FY23E	FY24E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Hero MotoCorp	2,613	21.1	19.3	15.2	13.0	10.9	8.1	20.1	19.3	20.7
Bajaj Auto	3,879	23.9	19.7	17.2	16.9	13.1	11.1	21.2	22.6	23.9
Eicher Motors	3,226	52.5	30.9	23.9	40.1	25.2	20.9	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

HMCL is a market leader in the Indian 2W industry. The company commands enjoys a leadership position in executive motorcycle segment. HMCL has strong penetration in semi-urban and rural areas, aided by its largest distribution network in the 2W industry. We expect Hero to benefit from 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. 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
Dhiraj Kapoor	Company Secretary and Chief Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bahadur Chand Investments Pvt Ltd	20.0
2	Munjal Pawankant	14.0
3	Munjal Brijmohan Lall	13.9
4	Life Insurance Corp of India	11.2
5	ICICI Pru AMC	3.7
6	Government Pension fund Global	2.5
7	WGI Emerging Markets Funds LLC	2.3
8	Blackrock Inc	2.3
9	Vanguard Group	2.2
10	SBI AMC	2.1

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

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