Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Company Update

Hero MotoCorp Ltd

Taking a 'premium' ride

Automobiles	Sharekhan code: HEROMOTOCO
Reco/View: Buy ↔	CMP: Rs. 3,876
	Price Target: Rs. 4,579 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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 11.62

Updated Aug 08, 2023

Low Risk

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

Source: Morningstar

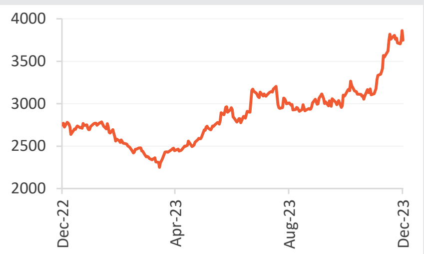
Company details

Market cap:	Rs. 77,575 cr
52-week high/low:	Rs. 3.904/2,247
NSE volume: (No of shares)	7.0 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.0 cr

Shareholding (%)

Promoters	34.8
FII	26.8
DII	29.1
Others	9.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	20.8	24.6	29.1	35.9
Relative to Sensex	14.3	20.9	19.1	25.2

Sharekhan Research, Bloomberg

Summary

- HMCL can build up dealer stocks from Q4FY24 as inventories are normal on strong festive sales.
- A new premium product from the 440 CC platform would strengthen its premium image.
- We maintain a Buy with a revised price target (PT) of Rs. 4579 on healthy recovery in EBITDA margin, strong response to HD X 440, continuous focus on premiumisation, expansion of its EV market and a likely revival in rural sales.
- Stock trades at a P/E multiple of 16.1 and EV/EBITDA multiple of 10.2x its FY2026 estimates

We reiterate our Buy call on Hero MotoCorp Ltd (HMCL) with a revised PT of Rs 4,579 on (1) Strong festive sales (19%), (2) Reduction in dealer inventory on healthy uptick in retail sales , (3) Continuous focus on premiumisation, (4) Beginning of a recovery in rural sales, (5) Strong order book for HD X 440 and Karizma, (5) Continuous focus on building long-term EV ecosystem and (6) Revival in EBITDA margins. Festive demand has been strong in both rural and urban segments. HMCL is benefiting by expansion of product portfolio. New products are getting a healthy response in the market and attractive financing schemes are attracting entry-level customers as well. The Xtec series of products is receiving a healthy response in the 125cc segment and Xtec products make up 20-22% of overall product line, emphasising their premium positioning. As most growth drivers are in place, the management is continues to eye EBITDA margins of 14-16%. We believe that the strong festive retail sales and a rural recovery along with assumed traction during wedding season have slashed dealer inventories and realignment of dispatches with retailers during the slow-moving period after the festive season would give company time to build up healthy dealer stock during H1CY24. After successful launch of HDX440, HMCL is expected to launch a new product on 440 cc platform in coming quarters.

- **Strong festive sales:** With a pick-up in retail sales, a low base and return of rural demand the domestic two-wheeler segment has witnessed strong traction in the festive season. FADA data shows the two-wheeler segment registered a 20.7% growth during this period. HCML recorded a 19% growth in volumes during the festive season to over 14 lakh units during (32 days of festive period), which as per the management was highest ever festive sales in its history. HMCL's secondary network in tier 2/ 3 cities including rural areas has witnessed 26% volume growth during festive season and its retail finance penetration has reached to 68%. This indicates that the recovery in volumes during the festive season was broad-based and not only an urban phenomenon. We believe that HMCL would be a key beneficiary of revival in rural demand as it has a strong distribution network and product offering in rural region.
- **Inventories normalise:** Going forward, we believe that inventory levels have fallen on a healthy uptick in retails during the festive season, which we believe would help the company in building up of stocks in coming months. With its strong presence in the entry level motorcycle segment HMCL has been aiming for a market share gain in the 125 cc segment. It is bringing premiumisation in its existing portfolio via launching Xtec versions of the products. Further continuously Post launching new products in the premium motorcycle segment to enhance market positioning. After its launch, the Xoom 110 cc the company has plans to expand Xoom brand via launching Xoom 125cc and Xoom 160 cc in the coming period. On the global front, HMCL has a presence in 47 cities and now planning to scale up its business in top 10 export markets.
- **EV journey picking up pace:** Its EV brand VIDA is now available with a 100-strong distribution network and the company is planning to expand its EV reach to 100 cities soon. Further, it has a tie up with Ather Energy for charging infrastructure. Broadly, the company has been strategically aiming to build up a strong eco system and simultaneously scaling up its manufacturing capacities. Currently HMCL is manufacturing 1000 electric scooters per week. We expect the production would increase gradually. HMCL has also introduced VIDA in European market, and we believe that gradually HMCL would play EV theme with a global ambition. Further, the company also plans to launch multiple products in EV segment in coming period. Further HMCL has entered in a partnership with Ather Energy for an interoperable fast-charging network in India. With this arrangement, the HMCL's customers will be able to use both VIDA and Ather's charging infrastructure across the country. The combined network will cover 100 cities with over 1900 fast charging points.

Our Call

Valuation – Maintain Buy with revised PT of Rs4579: HMCL has been continuously focussing on enhancing its distribution network. Recently it has upgraded its 200 stores under its Hero 2.0 project to enhance customer experience. Similarly, it continues to expand its product bandwidth and has thus far launched seven new versions across the product segment. Further few more product launches are under pipeline. It planning to expand its network for VIDA (EV) to 100 cities soon compared to three at the beginning of a calendar year. Besides, it has been building up EV charging infra to support EV volumes. While HMCL has been a strong mass-market player it has been gradually strengthening its presence in premium motorcycle segment also. Its efforts have started paying dividend as it enjoys an order book of over 25,000 units for Harley Davidson X 440 (HD X 440) and over 14000 units for Karizma. With a recovery in EBITDA margin, we believe HMCL gets a headroom to stimulate demand in its key markets for entry-level products as after premium category, 125-cc segment has already recovered. Further, the management has highlighted that rural demand has recovered during the festive season and assumes that demand traction would continue even after the festive season due to the upcoming marriage season. HMCL is also expected to launch few more products in premium motorcycle segment. The new product portfolio is getting a healthy response in the market and attractive financing schemes are attracting entry-level customers as well. We maintain our Buy rating on the stock with a revised target price (TP) of Rs. 4579 on a healthy recovery in EBITDA margin, strong response to HD X 440, continuous focus on premiumisation, expansion of its EV markets, and expectation of revival in rural sales.

Key Risks

As HMCL is looking for aggressive product launch plans and hence exposed to product failure risk. Rise in RM cost and rise in competition along with delay in recovery in rural market would stem its growth prospects.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	29,245	33,806	37,825	41,450	45,196
Growth (%)	-5.0	15.6	11.9	9.6	9.0
EBIDTA	3,369	3,986	4,917	5,596	6,418
OPM (%)	11.5	11.8	13.0	13.5	14.2
Recurring PAT	2,473	2,911	3,680	4,198	4,812
Growth (%)	-16.6	17.7	26.4	14.1	14.6
EPS (Rs)	124	146	184	210	241
PE (x)	31.3	26.6	21.0	18.4	16.1
P/BV (x)	4.9	4.6	4.2	3.8	3.4
EV/EBIDTA (x)	19.9	16.7	13.5	11.8	10.2
RoNW (%)	15.7	17.4	20.0	20.7	21.2
RoCE (%)	15.3	17.0	19.5	20.2	20.8

Source: Company; Sharekhan estimates

Focus on sustainable growth

While strong festive sales would support HMCL's volume growth and profitability, we believe that the management would continue to focus on strengthening its business model for a sustainable growth in the long term .Going forward, its key focus areas would be (1) improving the customer experience for a long-lasting experience via digitisation and new dealer formats;(2) Increasing presence in the scooter segment via an aggressive product launches; (3) Achieving a dominant position in the EV space; (4) revenue-driven growth model in place of plain-vanilla volume growth model; and (5) Premiumization across segments. Besides, the company is looking for a strategic focus on the top 10 export markets and aiming for a 14-16% EBIDTA margins.

Premiumisation is the key priority

Its Xtec series of products is receiving a healthy response in the 125cc segment, with this a power-packed and technologically advanced product is expected by Q4 to widen the product portfolio in the 125cc segment. Xtec products make up 20-22% of the overall product line, emphasising their premium positioning. Several growth initiatives are in place for the next few months, with production capacities set at 10,000 units per month for Harley and Karizma. HMCL has already delivered over 2,000 Harley Davidson 440 and with new orders of 2,000 units. The current order backlog for Harley Davidson 440 stands at 25,000 units. Similarly, Karizma has received advanced bookings for 14,000 units. The company has already launched its first premium store and looking for a 100-plus premium stores coming period.

EV business: Gradually catching up

The brand VIDA is getting a healthy response in the market. The EV business has impacted 90bps EBITDA margin in Q2FY2024, given the EV business is not profitable currently even at gross margin level due to lack of scale benefit. Management is aiming to expand its footprint in the EV space and targeting to reach 100 cities in the near term. It has opened up an exclusive store for EVs in Pune and looking for more exclusive stores in the medium term. HMCL has a 37.5% stake in Ather Energy and is looking for an operational synergy with Ather going forward. Production has reached 1,000 units per week and as the dealership network would expand. The company is prepared to scale up its volumes. Going forward, the company has plans to expand its product portfolio at multiple price points.

Eyeing EBITDA margin of 14-16%

Management continues to target a 14-16% EBITDA margin. They have guided for a capex of Rs. 1,000 crore for FY2024 and a larger part of the fund is assumed to be invested on EVs and enhancing premiumisation. The company has already launched 7 new models and targets to launch a few more new products in the coming period to revamp its product portfolio. Export volumes would be better in H2FY2024 compared to H1FY2024. With strong festive season, the reduction in inventory would allow the company to refill and build up stocks from Q4FY24 onwards. The new product portfolio is getting a healthy response in the market and attractive financing schemes are attracting entry-level customers as well.

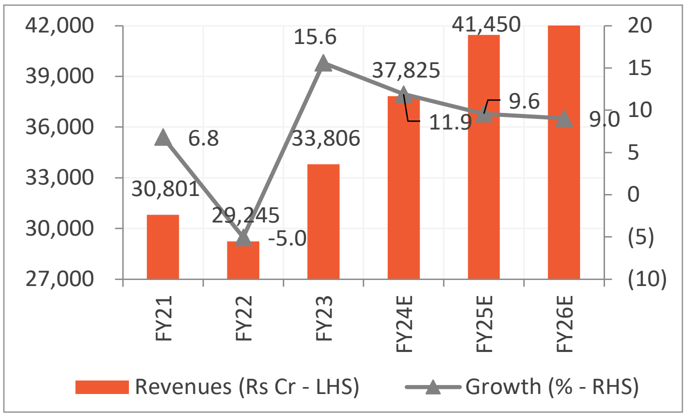
Change in earnings estimates Rs cr

Particulars	Earlier			New			% change		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY25E
Revenue	37,524	41,120	44,427	37,825	41,450	45,196	0.8%	0.8%	1.7%
EBITDA	4,766	5,551	6,220	4,917	5,596	6,418	3.2%	0.8%	3.2%
EBITDA margin	12.7%	13.5%	14.0%	13.0%	13.5%	14.2%	-	-	-
PAT	3,422	4,042	4,530	3,680	4,198	4,812	7.5%	3.8%	6.2%
EPS	171	202	227	184	210	241	7.5%	3.8%	6.2%

Source: Company, Sharekhan Research

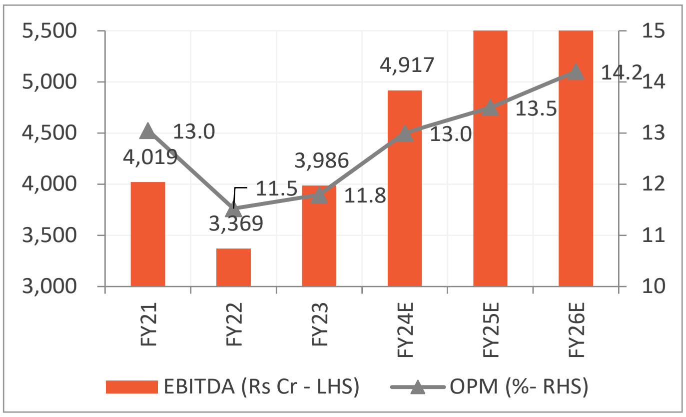
Financials in charts

Revenue and Growth Trend



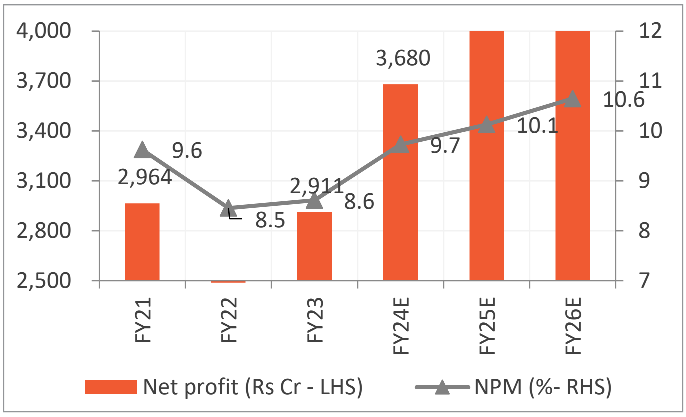
Source: Company, Sharekhan Research

EBITDA and OPM Trend



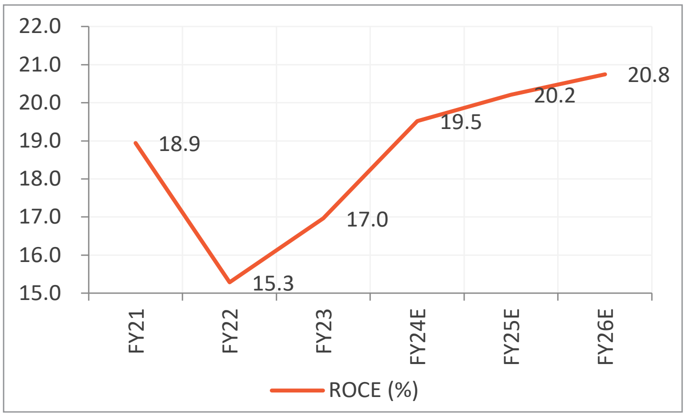
Source: Company, Sharekhan Research

Net Profit and NPM Trend



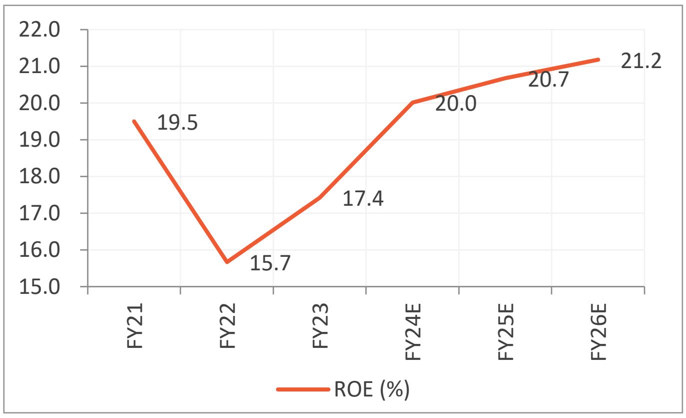
Source: Company, Sharekhan Research

ROCE Trend



Source: Company, Sharekhan Research

ROE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - steady improvement is on cards

We expect growth momentum to recover in FY2024E, driven by improvement in rural sentiments in the domestic market. The government's expenditure on infra segment coupled with increased preference for personal transport are expected to improve volumes. With rise in ownership cost due to price hikes and implementation of new regulations, the entry-level segment is facing headwinds, however the premium segment is continuously performing. While export volumes have been muted but reaching to bottom. The export volumes are expected to improve gradually in coming months. A positive recovery in African markets would augur well for the two-wheeler exports from India.

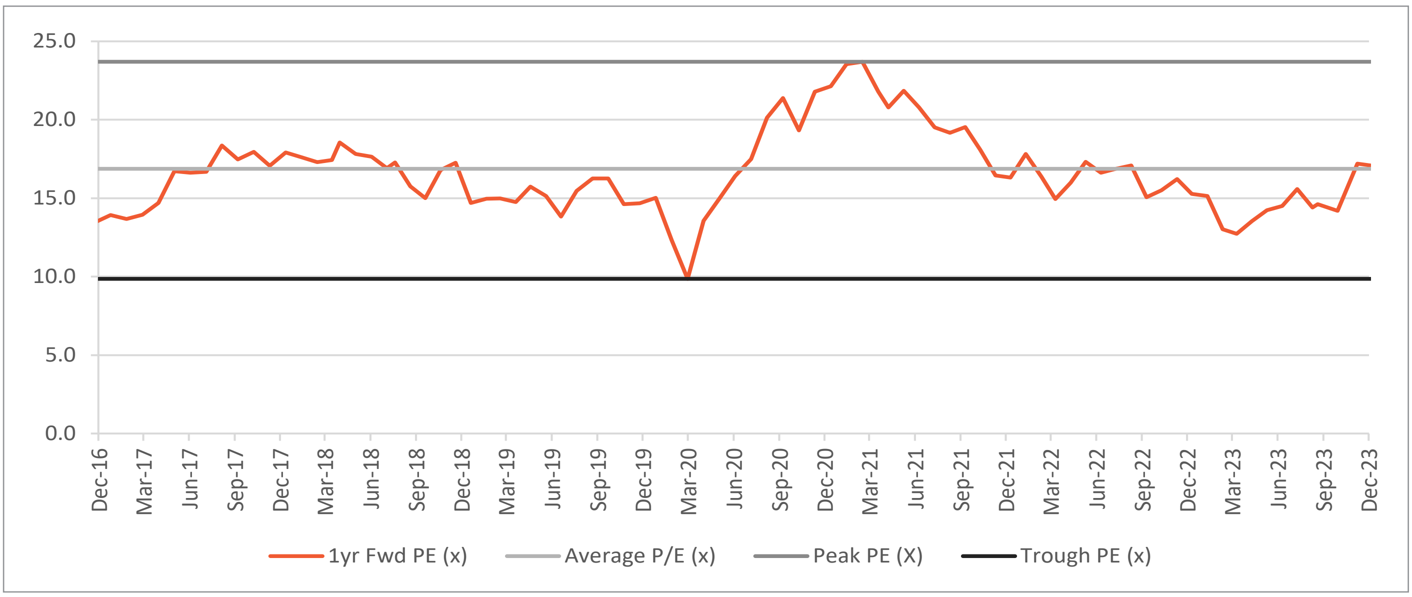
■ Company outlook - Entered late but eyeing on significant pie in EV space

Hero is the market leader commanding ~32.5% market share in the 2W space. Moreover, Hero has the highest rural exposure with rural sales contributing half of volumes. 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 payout 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 two-wheelers 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 revised PT of Rs 4579

HMCL has been continuously focussing on enhancing its distribution network. Recently it has upgraded its 200 stores under its Hero 2.0 project to enhance customer experience. Similarly, it continues to expand its product bandwidth and has thus far launched seven new versions across the product segment. Further few more product launches are under pipeline. It planning to expand its network for VIDA (EV) to 100 cities soon compared to three at the beginning of a calendar year. Besides, it has been building up EV charging infra to support EV volumes. While HMCL has been a strong mass-market player it has been gradually strengthening its presence in premium motorcycle segment also. Its efforts have started paying dividend as it enjoys an order book of over 25,000 units for Harley Davidson X 440 (HD X 440) and over 14000 units for Karizma. With a recovery in EBITDA margin, we believe HMCL gets a headroom to stimulate demand in its key markets for entry-level products as after premium category, 125-cc segment has already recovered. Further, the management has highlighted that rural demand has recovered during the festive season and assumes that demand traction would continue even after the festive season due to the upcoming marriage season. HMCL is also expected to launch few more products in premium motorcycle segment. The new product portfolio is getting a healthy response in the market and attractive financing schemes are attracting entry-level customers as well. We maintain our Buy rating on the stock with a revised target price (TP) of Rs. 4579 on a healthy recovery in EBITDA margin, strong response to HD X 440, continuous focus on premiumisation, expansion of its EV markets, and expectation of revival in rural sales.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

HMCL is the market leader in the 2W industry with a market share of 32.5%. HMCL is present in both the motorcycles and scooter segments, with a market share of about ~47% and ~7%, respectively. Motorcycles form the major chunk of revenue, contributing about ~93% to volumes, while scooters contribute about~ 7% of volumes. HMCL is a domestically focused company, deriving about 97% of its volumes from the Indian market. Further HMCL has entered into electric scooter space via brand VIDA.

Investment theme

HMCL is a market leader in the Indian 2W industry. The company commands 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 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 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 HMCL's market share in the segments. HMCL is expanding its product portfolio aggressively in the premium bikes segment.
- Failure in the premium segment can restrain its growth path.

Additional Data

Key management personnel

Dr. Pawan Munjal	Chairman,
Niranjan Gupta	CEO
Dhiraj Kapoor	Company Secretary and Chief Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Bahadur Chand Investments Pvt Ltd	20.03%
2	Munjal Pawan Kant	14.01%
3	Life Insurance Corp of India	11.21%
4	ICICI Prudential Asset Management Co Ltd/India	3.93%
5	Vanguard Group Inc/The	2.65%
6	Norges Bank	2.48%
7	WGI Emerging Markets Smaller Com	2.44%
8	BlackRock Inc	2.41%
9	SBI Funds Management Ltd	2.09%
10	Kotak Mahindra Asset Management Co Ltd/India	1.79%

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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