



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	✓	↔	✓

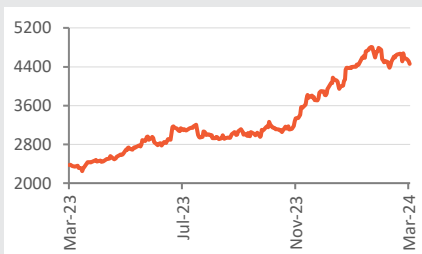
Company details

Market cap:	Rs. 90,675 cr
52-week high/low:	Rs. 4,979 / 2,246
NSE volume: (No of shares)	6.5 lakh
BSE code:	500182
NSE code:	HEROMOTOCO
Free float: (No of shares)	13.0 cr

Shareholding (%)

Promoters	37.8
FII	28.3
DII	28.1
Others	5.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.0	16.8	46.1	88.0
Relative to Sensex	-5.8	15.2	38.0	62.7

Sharekhan Research, Bloomberg

Hero MotoCorp Ltd

Riding on premiumisation

Automobiles

Sharekhan code: HEROMOTOCO

Reco/View: Buy



Upgrade



CMP: Rs. 4,539



Price Target: Rs. 6,057



Downgrade

Summary

- We retain our Buy rating on Hero MotoCorp with an unchanged PT of Rs. 6,057 on healthy recovery in EBITDA margin, strong response to its latest products, continuous focus on premiumization, and expansion of its EV markets.
- The underlying margin for ICs business has reached an upper band of its guidance of 16%.
- Management expects the two-wheeler industry to register double-digit revenue growth in FY2025.
- The stock trades at a P/E multiple of 16.5x and EV/EBITDA multiple of 11.1x its FY2026 estimates.

We reiterate our Buy rating on Hero MotoCorp (HMCL) on healthy recovery in EBITDA margin, strong response to its latest products, continuous focus on premiumization, and expansion of its EV markets. The company expects double-digit revenue growth for the two-wheeler industry in FY2025 and has guided to grow ahead of the industry due to its product launch strategies and, hence, a hope of market share gain. Premiumisation in individual sub segments would drive the two-wheeler segment's revenue performance in the coming years as customer aspirations in each of the sub segments has been rising. With continuous investment in the economy, entry-level customers would also come back on a rise in affordability. The premium scooter segment would continue to maintain traction in FY2025. The company aims to gain a meaningful market share in the premium motorcycle segment in the next five years. Broadly, commodity costs have been stabilised and the company continues to aspire for an EBITDA margin of 14-16%. Financing support has been a big driver for the two-wheeler segment's growth. Financing penetration has reached 60-65%. The rise in financing penetration would drive the two-wheeler segment's growth on easy availability of funding to the low-income group of customers. The company would focus on more of its top-10 export markets out of 50 markets in hand.

- Underlying EBITDA margin is improving:** HMCL has guided for double-digit revenue growth in the two-wheeler industry in FY25. The company aims to continue to expand its premium product portfolio in the coming years. Along with motorcycles, HMCL targets expanding its EV products and ICs scooter portfolios in FY2025. At the operating performance front, the company continues to target an EBITDA margin range of 14-16%. Underlying EBITDA margin has already reached 16% in Q3FY2024. However, incremental volume growth has not been reflected in the improvement in per unit profitability as the company has been investing in the EV business, given HMCL has invested 200bps of margin in its EV business. With an improvement in operating profitability in the ICs business and continuous investment in the EV business, we believe HMCL has been delivering strong performance, while it has been building up a balanced future. Going forward, the company continues to focus on expanding its penetration in the premium segment by launching new products. Along with strengthening its product portfolio in the vehicle segment, the company has lined up a capex of Rs. 600 crore to enhance its revenue potential in the spare parts business on an annual basis from Rs. 5,000 crore to Rs. 10,000 crore by FY2027.
- Building up the premium portfolio:** The company recently unveiled two more premium motorcycles – Xtreme 125 R and Maverick 440 – to strengthen its premium product portfolio. The bookings for Maverick 440 would start in February 2024, and deliveries are expected in April 2024. Maverick: bookings would start in February and delivery would begin from April 2024. Beyond that, it is planning to launch 125cc and 160cc scooters in H1FY2025. Along with its vehicle business, the company has been continuously focusing on building up its non-vehicle revenue. The company plans to expand its spare parts capacity from 26,000 SKUs to 36,700 SKUs via investing Rs. 600 crore over by FY2027. In the last 3-4 years, the merchandise business has grown up from Rs. 3,000 crore to Rs. 5,000 crore on annual basis, driven by its micro-focus strategy for the merchandise business. With an investment of Rs. 600 crore, the company is aiming to achieve a revenue potential of Rs. 10,000 crore per annum from the merchandise business.
- Plan to expand its EV offerings:** HMCL plans to invest 125-150 bps margin investment in the EV business in FY2024. The company continues to invest and expand its EV business as it has already expanded to 100 cities in the domestic market. In Q3FY2024 the company invested 200bps of its margin in the EV business. In collaboration with Ather Energy, the company has been successfully building up the charging infrastructure. The company plans to launch multiple EV products in the coming period in the mid and entry-level segments. HMCL plans to have its EV products at three competitive price points by Q1FY2025. Beyond the domestic market, the company has plans to expand its footprint in the European EV market. Despite being an established brand, HMCL has continuously invested in building up brand equity for its EV brand, VIDA. The company has been ramping up its capacity in the EV segment in line with the rising penetration and buildup of the ecosystem.

Our Call

Valuation – Maintain BUY with an unchanged PT of Rs. 6,057: With a slew of launches and renewed focus on the premium motorcycle segment, the company has registering traction in its business, given the recovery in the two-wheeler segment is supporting its topline performance, focusing on brands, models, portfolios, and premium stores. Further, the brand association with Harley Davidson is supporting the company in building up a formidable image in the iconic motorcycle segment. With a recovery in EBITDA margin, we believe HMCL has a headroom to stimulate demand in its key markets for entry-level products as after the premium category, the 125cc segment has already recovered. With its Hero 2.0 stores, the company is continuing to focus on bringing premiumisation to its distribution system. Exclusive stores for premium products and upgradation of the existing dealership network would help it attract a new set of customers. Further, it is aggressively planning to expand its EV business. Along with that, the company plans to focus on its top-10 export markets to increase its business from overseas markets. We retain our BUY rating on the stock with an unchanged PT of Rs. 6,057 on healthy recovery in EBITDA margin, strong response to its latest products, continuous focus on premiumisation, and expansion of its EV markets.

Key Risks

HMCL is looking for aggressive product launch plans and, hence, it is exposed to product failure risk. Any rise in RM cost and increased competition along with a delay in recovery in the rural market would stem its growth prospects.

Valuation (Standalone)

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	29,245	33,806	36,884	40,862	45,178
Growth (%)	-5.0	15.6	9.1	10.8	10.6
EBIDTA	3,369	3,986	5,164	6,048	7,093
OPM (%)	11.5	11.8	14.0	14.8	15.7
APAT	2,473	2,911	4,014	4,674	5,498
Growth (%)	-16.6	17.7	37.9	16.5	17.6
AEPS (Rs)	124	146	201	234	275
P/E (x)	36.7	31.1	22.6	19.4	16.5
P/B (x)	5.7	5.4	4.8	4.3	3.8
EV/EBIDTA (x)	23.8	20.0	15.4	13.1	11.1
RoE (%)	15.7	17.4	21.4	22.4	23.2
RoCE (%)	15.3	17.0	20.9	21.9	22.7

Source: Company; Sharekhan estimates

New products are receiving a healthy response

The new product portfolio is getting a healthy response in the market and attractive financing schemes are attracting entry-level customers also. Xtec series of products is receiving a healthy response in the 125cc segment. The company is continuing to widen its product portfolio in the above 125cc segment. Xtec products make up 20-22% of the overall product line, emphasising on their premium positioning. With Karizma, Mavrick, and HD X440, HMCL now has five models in the premium segment, which is equivalent to its five models in the up to 125cc segment. Further, HD X 440 has already cornered a booking of over 30,000 units, which reflects the acceptance of premium iconic products from a leading mass market player.

Emerging as a focused EV player

Management is aiming to expand its footprint in the EV space and is targeting to reach 100 cities in the near term. HMCL has an 8-10% market share in the scooter segment and, hence, any rise in penetration of the electric scooter segment is offering an opportunity for HMCL would expand its market share in the electric scooter space. The company's EV brand, VIDA, is now available with over 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 ecosystem and is simultaneously scaling up its manufacturing capacities. HMCL has also introduced VIDA in the European market, and we believe gradually HMCL would play the EV theme with a global ambition. Further, the company also plans to launch multiple products in the EV segment in the coming period. Further, HMCL has entered into a partnership with Ather Energy for an interoperable fast-charging network in India. With this arrangement, HMCL's customers will be able to use both VIDA and Ather's charging infrastructure across the country. Ather enjoys an 11% market share in the domestic electric two-wheeler market.

Rural demand: Partially recovering

Rural demand was healthy during the festive season, and enquiries from the rural segment have been increasing. Rural enquiries have reached 50-55% of the total enquiries compared to 40% earlier. Inventory levels are assumed to be in the normal range of 4-6 weeks, given that retail sales during the festive season were higher than that of wholesale and have room to build up dealer stock ahead of the upcoming Navratri season in April 2024. HMCL has been taking judicious and justified price hikes as per the positioning of the product in the market to save margins without impacting the demand. We believe as the company has attained its desired EBITDA margin range (14-16%), it would now have room to invest on demand stimulation. Along with its vehicle business, the company has been continuously focusing on building up its non-vehicle revenue. The company plans to expand its spare parts capacity from 26,000 SKUs to 36,700 SKUs via investing Rs. 600 crore over by FY2027.

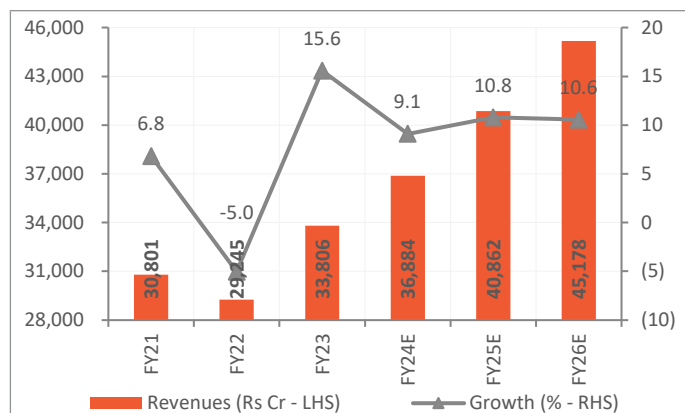
Change in estimates

Particulars	Earlier			New			% change		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY25E
Revenue	36,884	40,862	45,178	36,884	40,862	45,178	-	-	-
EBITDA	5,164	6,048	7,093	5,164	6,048	7,093	-	-	-
EBITDA margin	14.0%	14.8%	15.7%	14.0%	14.8%	15.7%	-	-	-
PAT	4,014	4,674	5,498	4,014	4,674	5,498	-	-	-
EPS (Rs.)	201	234	275	201	234	275	-	-	-

Source: Company; Sharekhan Research

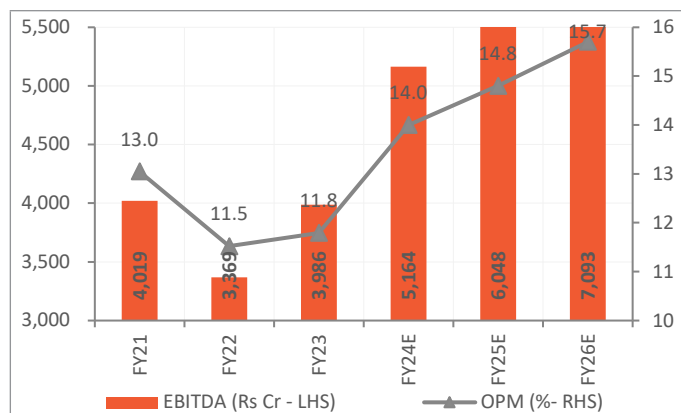
Financials in charts

Revenue and Growth Trend



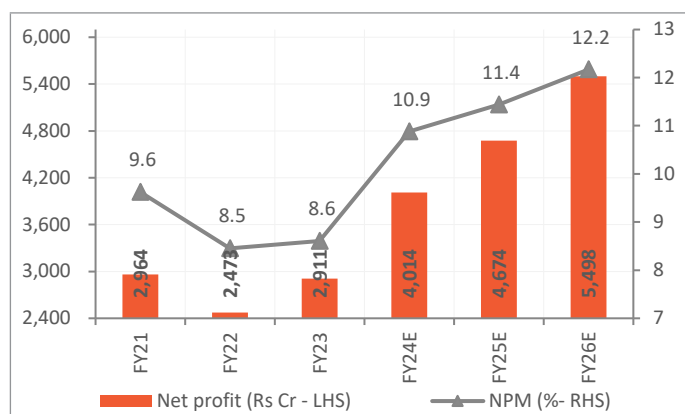
Source: Company, Sharekhan Research

EBITDA and OPM Trend



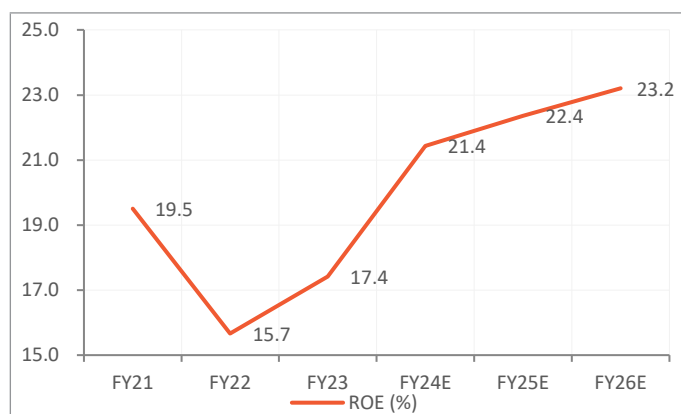
Source: Company, Sharekhan Research

Net Profit and NPM Trend



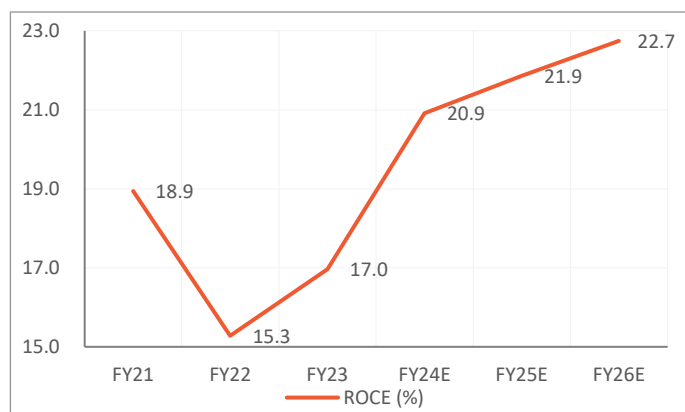
Source: Company, Sharekhan Research

ROE Trend



Source: Company, Sharekhan Research

ROCE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – 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 the infra segment coupled with increased preference for personal transport is expected to improve volumes. With an increase 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 their bottom levels. Export volumes are expected to improve gradually in the coming months. A positive recovery in African markets would augur well for two-wheeler exports from India.

■ Company Outlook – Entered late but eyeing on a significant pie in the EV space

HMCL is the market leader in the two-wheeler space. Moreover, the company 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 HMCL to retain its leadership position. The company has a strong balance sheet with net cash. HMCL has a healthy dividend pay-out ratio of 55-65%. The company 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 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 about the company's growth prospects.

■ Valuation – Maintain BUY with an unchanged PT of Rs. 6,057

With a slew of launches and renewed focus on the premium motorcycle segment, the company has registering traction in its business, given the recovery in the two-wheeler segment is supporting its topline performance. focusing on brands, models, portfolios, and premium stores. Further, the brand association with Harley Davidson is supporting the company in building up a formidable image in the iconic motorcycle segment. With a recovery in EBITDA margin, we believe HMCL has a headroom to stimulate demand in its key markets for entry-level products as after the premium category, the 125cc segment has already recovered. With its Hero 2.0 stores, the company is continuing to focus on bringing premiumisation to its distribution system. Exclusive stores for premium products and upgradation of the existing dealership network would help it attract a new set of customers. Further, it is aggressively planning to expand its EV business. Along with that, the company plans to focus on its top-10 export markets to increase its business from overseas markets. We retain our BUY rating on the stock with an unchanged PT of Rs. 6,057 on healthy recovery in EBITDA margin, strong response to its latest products, continuous focus on premiumisation, and expansion of its EV markets.

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 a 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 the electric scooter space via brand, VIDA.

Investment theme

HMCL is a market leader in the Indian two-wheeler industry. The company commands a leadership position in the executive motorcycle segment. HMCL has strong penetration in semi-urban and rural areas, aided by its largest distribution network in the two-wheeler industry. We expect HMCL 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. HMCL 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 Website

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	8.88
4	ICICI Prudential Asset Management	3.88
5	Vanguard Group Inc/The	2.66
6	Norges Bank	2.54
7	BlackRock Inc	2.51
8	WGI EMERGING MARKETS SMALLER COM	2.45
9	Kotak Mahindra Asset Management Co	2.17
10	SBI Funds Management Ltd	2.07

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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