

HOLD

TP: Rs 3,009 | ▼ 3%

HERO MOTOCORP

| Automobiles

| 03 November 2023

Poised for growth but upside capped

- Q2 revenue grew 4% YoY driven by realisation gains as volumes stayed flat at 1.4mn units.
- Drop in raw material cost to 69% of sales vs. 72% in year-ago quarter helped boost gross margin by 340bps YoY to 31.4%
- Maintain HOLD with unchanged TP of Rs 3,009, valuing core operations at 15x FY25E EPS

Volumes flat, realisations move up: HMCL's Q2FY24 revenue grew 4% YoY (+8% QoQ) to Rs 94.5bn steered by realisation gains as volumes stayed flat (+5% QoQ) at 1.4mn units. Net realisation per vehicle (NRPV) grew 5% (+3% QoQ) to Rs 66.7k.

Operating leverage aids margin improvement: Raw material cost adjusted for inventory was flat YoY (+7% QoQ) and reduced as a percentage of sales to 69% from 72% in Q2FY23, aiding gross margin improvement of 340bps YoY (+80bps QoQ) to 31.4%. However, new launches added to promotional cost, pushing other expenses up 11% YoY (+18% QoQ) to Rs 10.6bn. EBITDA rose 28% YoY (+10% QoQ) to Rs 13.3bn, with 260bps (+30bps QoQ) margin expansion to 14.1%. Adj. PAT climbed 47% YoY (+7% QoQ) to Rs 10.5bn, further backed by a 170% surge in other income to Rs 2.5bn due to revaluation of investments.

Focus on launches: *Karizma XMR* bookings currently stand at ~14k units. Deliveries for the Harley-Davidson *X440* (>2k units) have commenced across 100 stores and the order book was at 25k+ as of Q2. Management is looking to ramp up production for Karizma and Harley to ~10k units/month, besides indicating aggressive launches across segments over FY24. The focus will be on recovery in the 125cc segment, building the premium portfolio and improving market share.

Rural demand picking up: Rural demand moved up in the festive season (Sep-Nov) with volume growth of 15% (as guided by the management) evenly split between rural and urban demand – a positive signal as HMCL remains a market leader in entry-level motorcycles.

Retain HOLD: We continue to model for a revenue/ EBITDA/adj. PAT CAGR of 16%/21%/21% over FY22-FY25, with EBITDA margin averaging at ~13%. Steady rural recovery, export market revival and the response to HMCL's aggressive launch programme remain key to watch. Our SOTP-based TP remains at Rs 3,009, based on an unchanged P/E multiple of 15x FY25E for core operations. Maintain HOLD as positives are in the price.

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Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	HMCL IN/Rs 3,089
Market cap	US\$ 7.5bn
Free float	65%
3M ADV	US\$ 19.5mn
52wk high/low	Rs 3,275/Rs 2,246
Promoter/FPI/DII	35%/30%/24%

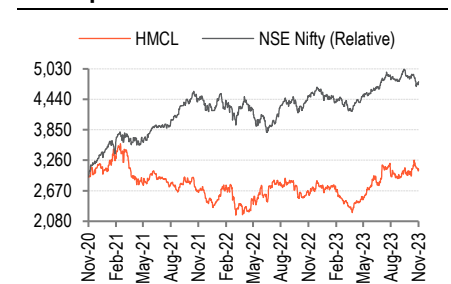
Source: NSE | Price as of 3 Nov 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	3,38,057	3,89,963	4,57,480
EBITDA (Rs mn)	39,862	49,606	60,382
Adj. net profit (Rs mn)	29,106	36,131	43,386
Adj. EPS (Rs)	145.8	180.9	217.3
Consensus EPS (Rs)	145.8	190.0	213.0
Adj. ROAE (%)	17.4	19.7	21.0
Adj. P/E (x)	21.2	17.1	14.2
EV/EBITDA (x)	15.4	12.4	10.0
Adj. EPS growth (%)	17.7	24.1	20.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Earnings call highlights

Parameter	Q2FY24	Q1FY24	Our view
Volumes	<p>HMCL's sales volume in Q2FY24 grew 4.7% QoQ (flat YoY) to 1.4mn units. Festive season volume growth was 15% YoY as rural demand picked up.</p> <p>Management is focusing on the 125cc segment which should translate into higher volumes over the next few quarters. The 100cc portfolio that has been impacted for the last 4-5 years is recovering (<i>Passion</i> grew 2x in Q2). HMCL has gained market share in 110cc scooters due to <i>Xoom</i>.</p> <p>The central, northern and southern markets are performing well while the eastern markets have picked up.</p>	<p>Sales volume in Q1FY24 grew 6.5% QoQ to 1.35mn units.</p> <p>Management indicated that the focus will be on volumes and market share as operating margin recovery is complete and it is back to pre-Covid levels of ~14%.</p> <p>The commuter segment is also seeing a progressive recovery as replacement demand increased from 4-5% YoY to 10% in Jul'23.</p>	Retention of market leadership in the lower end 100cc bikes is key. HMCL also has an aggressive plan to build its presence in the higher end segment.
Margins	<p>EBITDA for Q2FY24 grew 28% YoY to Rs 13.3bn and operating margin stood at 14.1% (+260bps YoY) as a result of softer commodity cost and a better product mix.</p> <p>ICE margins stood at ~15% with a ~90bps drag from the EV segment.</p> <p>Management indicated that price hikes taken during Q2FY24 were not ahead of industry hikes.</p>	<p>EBITDA for Q2FY24 grew 28% to Rs 12.1bn and operating margin was at 13.8% (+255bps) as a result of commodity cost softening, benefits from cost reduction programmes and price hikes.</p> <p>Management indicated that the EV business dragged the overall margin down ~100bps but expects this drag to reduce in tandem with rising volumes due to economies of scale.</p> <p>ICE margin in Q2FY24 stood at ~14.5% and is expected to remain at 14-15% over the next few quarters.</p>	Softening cost is aiding margin recovery. Realisation gains should continue to accrue from a better product mix.
Premiumisation	<p><i>Karizma XMR</i> bookings currently total ~14k units. Deliveries for Harley-Davidson <i>X440</i> (>2k) have commenced across 100 stores and the current order book for <i>X440</i> stands at 25k+.</p> <p>Management is looking to ramp up production for <i>Karizma</i> and <i>Harley</i> to ~10k units per month.</p> <p>HMCL has launched its 'Premia' dealership store and expects to scale up to 100 stores in six months. Hero 2.0 stores are expected to reach 500 in the next six months from 200 now.</p>	<p>Harley Davidson <i>X440</i> has received 25k+ bookings.</p> <p>Management indicated that it will be launching <i>Karizma XMR</i> and <i>Xtreme 125</i> in FY24 with a focus on driving revenue, profitability and market share in the premium segment.</p> <p>The Hero 2.0 initiative has resulted in higher buyer conversion across products and across its 38 sample dealers with an additional 200-300 dealers registering interest in the programme.</p>	HMCL lags behind in the premium segment, though its current strategy of targeting high-end products is a step in the right direction.
Electric vehicles	<p>EV production has been at >1k units per week for the last 3-4 weeks. Management expects to expand to ~100 cities.</p> <p>The EV segment is not profitable (negative gross profit), given a focus on building the brand and portfolio.</p> <p>HMCL has a 37.5% stake in Ather Energy at end-Q2FY24. The company has developed a 2W fast charger connector in collaboration with Ather.</p> <p>HMCL enjoys a differentiated detachable battery structure compared to other companies who have a non-detachable structure.</p>	<p>HMCL has added 33 new EV dealers in Q1, taking the total to 36, and is on track to reach 100 dealers by end-FY24.</p> <p>The company is expanding the charging infrastructure and is focused on increasing its reach in the EV segment. Management stated that it is working on the entry- and mid-segment EV portfolio and will announce launches shortly.</p> <p>HMCL is expanding its charging infrastructure and has partnered with Ather for a common connector and interoperable charging network for expanded charging network availability.</p>	Differentiated EV products have resulted in a healthy buyer response in the initial phase.

Parameter	Q2FY24	Q1FY24	Our view
Others	<p>Spares revenue during Q2FY24 stood at Rs 13.5bn.</p> <p>Other expenses grew 11% YoY to Rs 10.6bn as a result of new launches.</p> <p>Current inventory levels are high and management expects a return to normal levels 4-6 weeks after the festive season.</p> <p>Receivables as on Q2FY24 stood at Rs 42.8bn as a result of extended credit to dealers on account of the festive season.</p>	<p>Spares revenue during Q2FY24 stood at Rs 12.1bn (~14% of total revenue).</p> <p>Other expenses grew 11.6% YoY to Rs 90bn because of seasonality; marketing expenses are likely to stay elevated due to planned launches.</p> <p>Exceptional expenses of ~Rs 1.6bn were incurred during Q2FY24 towards a voluntary retirement scheme that ~10% of staff opted for.</p> <p>HMCL has invested Rs 225mn in its subsidiary HMCL Netherlands B.V. in Q1.</p>	<p>Inventory and receivables are traditionally higher during the festive season but should return to normal once the season ends.</p>

Source: Company, BOBCAPS Research | 2W: Two-wheelers, ICE: Internal Combustion Engine

Fig 2 – Quarterly performance

(Rs mn)	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)	H1FY24	H1FY23	YoY (%)
Volume	1,416,526	1,428,168	(0.8)	1,352,574	4.7	2,769,100	2,818,361	(1.7)
Avg. Realisation per Vehicle	66,680	63,545	4.9	64,819	2.9	65,771	61,979	6.1
Net Revenues	94,454	90,754	4.1	87,673	7.7	182,127	174,679	4.3
Total Income (A)	94,454	90,754	4.1	87,673	7.7	182,127	174,679	4.3
Operating Expenses:								
Raw materials consumed	64,780	65,301	(0.8)	60,809	6.5	125,589	126,375	(0.6)
Employee Expenses	5,768	5,490	5.1	5,802	(0.6)	11,569	10,872	6.4
Other Expenses	10,624	9,579	10.9	9,000	18.0	19,623	17,641	11.2
Total Expenditure (B)	81,171	80,370	1.0	75,610	7.4	156,782	154,888	1.2
EBITDA (A-B)	13,283	10,383	27.9	12,063	10.1	25,345	19,791	28.1
Other Income	2,483	921	169.7	2,222	11.8	4,705	1,450	224.4
Depreciation	1,749	1,634	7.0	1,690	3.5	3,439	3,264	5.4
EBIT	14,017	9,670	45.0	12,595	11.3	26,612	17,978	48.0
Finance Costs	48	33	43.8	47	2.1	94	103	(8.5)
PBT before exceptional items	13,970	9,637	45.0	12,548	11.3	26,517	17,875	48.4
Exceptional items	-	-	-	1,600	(100.0)	1,600	-	-
PBT after exceptional items	13,970	9,637	45.0	10,948	27.6	24,918	17,875	39.4
Tax expense	3,431	2,476	38.6	2,701	27.1	6,132	4,469	37.2
Reported PAT	10,538	7,161	47.2	8,247	27.8	18,785	13,406	40.1
Adjusted PAT	10,538	7,161	47.2	9,847	7.0	20,385	13,406	52.1
Adj EPS (Rs)	52.8	35.9	47.2	49.3	7.0	102	67.1	52.1
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	31.4	28.0	337	31	78	31.0	27.7	339
EBITDA Margin	14.1	11.4	262	14	30	13.9	11.3	259
EBIT Margin	14.8	10.7	419	14	47	14.6	10.3	432
PBT Margin	14.8	10.6	417	14	48	14.6	10.2	433
Tax Rate	24.6	25.7	(113)	25	(11)	24.6	25.0	(39)
Adj PAT Margin	11.2	7.9	327	11	(7)	11.2	7.7	352

Source: Company, BOBCAPS Research

Valuation methodology

We continue to model for a revenue/ EBITDA/adj. PAT CAGR of 16%/21%/21% over FY22-FY25, with EBITDA margin averaging at ~13%. Steady rural recovery, export market revival and the response to HMCL's aggressive launch programme remain key to watch. Our SOTP-based TP remains at Rs 3,009, based on an unchanged P/E multiple of 15x FY25E for core operations. Maintain HOLD as positives appear to be priced in.

Fig 3 – Key assumptions

Parameter	FY22	FY23	FY24E	FY25E
Volume	49,44,132	53,28,546	58,54,013	65,40,537
Realisation (Rs)	59,152	63,443	66,615	69,945
EBITDA (Rs)	33,688	39,862	49,606	60,382
EBITDA margin (%)	11.5	11.8	12.7	13.2
Adj. PAT (Rs)	24,730	29,106	36,131	43,386

Source: Bloomberg, BOBCAPS Research

Fig 4 – Valuation summary

Business	FY25E EPS (Rs)	Target P/E (x)	Value (Rs)
Standalone Business	217	13	2,879
Other Business	-	-	130
Total	-	-	3,009

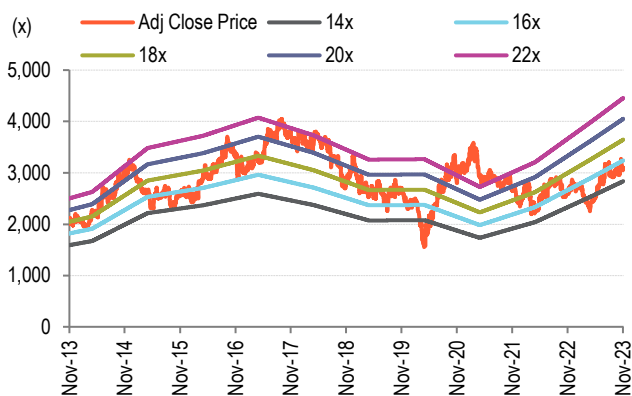
Source: BOBCAPS Research

Fig 5 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EPS (Rs)		ROE (%)	
				FY24E	FY25E	FY24E	FY25E
Hero Motocorp	HMCL IN	HOLD	3,009	180.9	217.3	20.6	22.3
TVS Motor Company	TVSL IN	HOLD	1,252	40.8	56.7	28.1	30.0
Bajaj Auto	BJAUT IN	HOLD	4,188	247.7	294.7	25.8	26.5

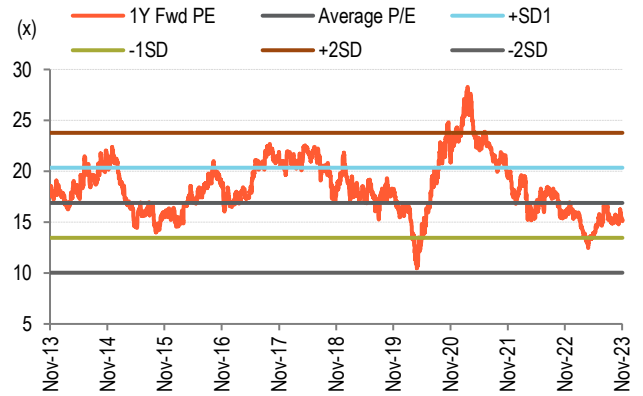
Source: BOBCAPS Research

Fig 6 – P/E band



Source: Bloomberg, BOBCAPS Research

Fig 7 – Stock is fairly valued at the current level



Source: Bloomberg, BOBCAPS Research

Key risks

- A better-than-expected response to HMCL's high-end products in the 125cc+ segment would be a key upside risk to our estimates.
- Continued raw material cost inflation and later-than-expected demand revival, especially in the rural segment, represent key downside risks.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Ashok Leyland	AL IN	6.0	168	210	BUY
Bajaj Auto	BJAUT IN	18.9	5,369	5,139	HOLD
Eicher Motors	EIM IN	11.4	3,428	3,601	HOLD
Escorts	ESCORTS IN	4.9	3,076	2,343	SELL
Hero MotoCorp	HMCL IN	7.5	3,089	3,009	HOLD
Mahindra & Mahindra	MM IN	22.4	1,469	1,824	BUY
Maruti Suzuki	MSIL IN	37.8	10,276	11,562	HOLD
TVS Motor	TVSL IN	9.2	1,599	1,531	HOLD
VST Tillers Tractors	VSTT IN	0.4	3,583	3,464	HOLD

Source: BOBCAPS Research, NSE | Price as of 3 Nov 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Total revenue	3,08,006	2,92,455	3,38,057	3,89,963	4,57,480
EBITDA	40,193	33,688	39,862	49,606	60,382
Depreciation	6,769	6,498	6,570	7,365	8,272
EBIT	39,222	32,759	38,944	47,780	57,724
Net interest inc./(exp.)	(218)	(258)	(199)	(240)	(259)
Other inc./(exp.)	5,799	5,569	5,652	5,539	5,614
Exceptional items	0	0	0	0	0
EBT	39,004	32,501	38,746	47,540	57,465
Income taxes	9,362	7,771	9,640	11,410	14,079
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	29,642	24,730	29,106	36,131	43,386
Adjustments	0	0	0	0	0
Adjusted net profit	29,642	24,730	29,106	36,131	43,386

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	52,046	44,498	49,638	60,252	70,589
Other current liabilities	8,913	7,595	8,151	8,559	8,987
Provisions	3,328	3,385	3,738	3,925	4,121
Debt funds	0	0	0	0	0
Other liabilities	1,298	0	0	0	0
Equity capital	400	400	400	400	400
Reserves & surplus	1,51,585	1,57,429	1,66,651	1,82,714	2,06,131
Shareholders' fund	1,51,984	1,57,829	1,67,051	1,83,113	2,06,531
Total liab. and equities	2,17,570	2,13,307	2,28,578	2,55,850	2,90,228
Cash and cash eq.	2,572	1,751	3,455	11,517	15,490
Accounts receivables	24,268	23,043	27,982	31,197	36,598
Inventories	14,696	11,227	14,341	15,599	18,299
Other current assets	6,601	11,950	14,498	15,223	15,984
Investments	1,04,997	1,06,523	1,10,104	1,23,104	1,41,104
Net fixed assets	59,884	58,065	57,614	59,750	59,478
CWIP	4,366	4,582	4,638	3,400	7,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(4,041)	(3,833)	(4,054)	(3,939)	(3,724)
Other assets	4,229	0	0	0	0
Total assets	2,17,570	2,13,307	2,28,578	2,55,850	2,90,228

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Cash flow from operations	42,251	18,812	25,189	43,812	47,883
Capital expenditures	(6,435)	(4,894)	(6,175)	(8,262)	(11,600)
Change in investments	(22,770)	(1,526)	(3,580)	(13,000)	(18,000)
Other investing cash flows	5,799	5,569	5,652	5,539	5,614
Cash flow from investing	(23,407)	(852)	(4,104)	(15,723)	(23,986)
Equities issued/Others	131	106	71	(71)	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(218)	(258)	(199)	(240)	(259)
Dividends paid	(18,978)	(18,992)	(19,983)	(19,969)	(19,969)
Other financing cash flows	113	(208)	221	(114)	(215)
Cash flow from financing	(18,953)	(19,352)	(19,890)	(20,394)	(20,443)
Chg in cash & cash eq.	(109)	(1,391)	1,195	7,694	3,454
Closing cash & cash eq.	2,572	1,751	3,455	11,517	15,490

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	148.4	123.8	145.8	180.9	217.3
Adjusted EPS	148.4	123.8	145.8	180.9	217.3
Dividend per share	95.0	95.1	100.1	100.0	100.0
Book value per share	761.1	790.4	836.6	917.0	1,034.3

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	2.0	2.1	1.8	1.6	1.3
EV/EBITDA	15.3	18.2	15.4	12.4	10.0
Adjusted P/E	20.8	24.9	21.2	17.1	14.2
P/BV	4.1	3.9	3.7	3.4	3.0

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	76.0	76.1	75.1	76.0	75.5
Interest burden (PBT/EBIT)	99.4	99.2	99.5	99.5	99.6
EBIT margin (EBIT/Revenue)	12.7	11.2	11.5	12.3	12.6
Asset turnover (Rev./Avg TA)	208.2	188.0	208.1	222.7	234.8
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	20.2	16.0	17.9	20.6	22.3

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
YoY growth (%)					
Revenue	6.8	(5.0)	15.6	15.4	17.3
EBITDA	1.5	(16.2)	18.3	24.4	21.7
Adjusted EPS	0.3	(16.6)	17.7	24.1	20.1
Profitability & Return ratios (%)					
EBITDA margin	13.0	11.5	11.8	12.7	13.2
EBIT margin	12.7	11.2	11.5	12.3	12.6
Adjusted profit margin	9.6	8.5	8.6	9.3	9.5
Adjusted ROAE	19.5	15.7	17.4	19.7	21.0
ROCE	20.2	16.0	18.0	20.7	22.4
Working capital days (days)					
Receivables	24	30	28	28	27
Inventory	15	16	14	14	14
Payables	69	85	72	73	74
Ratios (x)					
Gross asset turnover	0.5	0.5	0.4	0.4	0.4
Current ratio	0.7	0.9	1.0	1.0	1.0
Net interest coverage ratio	(179.6)	(127.0)	(196.0)	(199.1)	(222.9)
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**

Brand Name: **BOBCAPS**

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

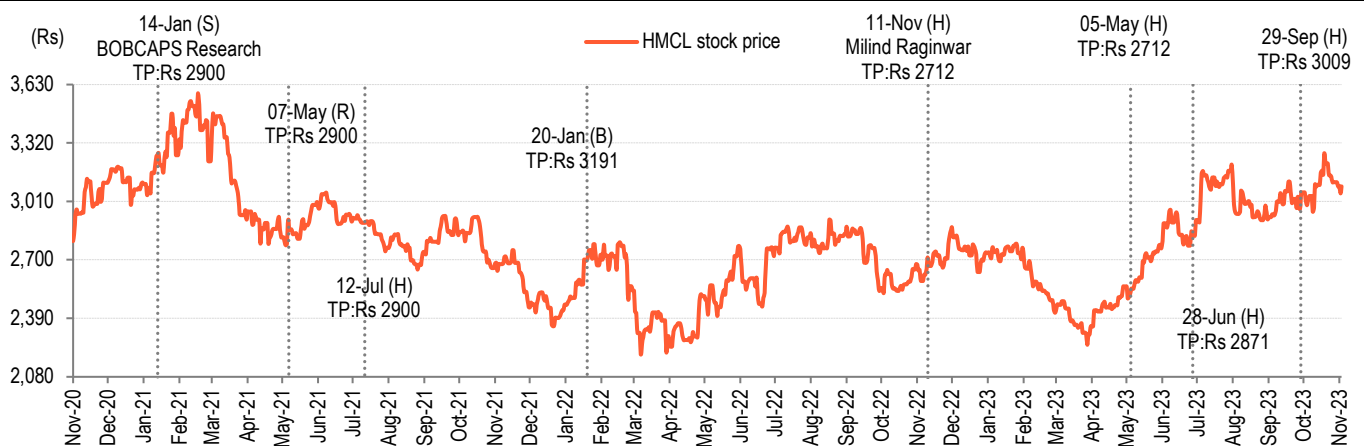
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): HERO MOTOCORP (HMCL IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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