

HOLD
 TP: Rs 4,671 | ▼ 5%

HERO MOTOCORP

| Automobiles

| 12 February 2024

Healthy quarter but positives priced in

- Q3 revenue grew 21% YoY steered by 17% growth in motorcycle volumes and 22% in scooters; realisations up 3%
- Lower raw material cost as proportion of sales lifted gross margin by 210bps YoY to 32.7%
- TP raised to Rs 4,671 (vs. Rs 3,009) on higher target P/E of 17x (vs. 15x) for core business and rollover; maintain HOLD

Milind Raginwar | Shree Kirloskar
 research@bobcaps.in

Volumes surge, realisations flattish: HMCL's Q3FY24 revenue grew 21%/3% YoY/QoQ to Rs 97.2bn, steered by volume gains of 18%/3% YoY/QoQ to 1.46mn units. The volume surge was supported by 17% YoY (flat QoQ) growth in motorcycles and 22% YoY (+23% QoQ) growth in scooters. Net realisation per vehicle inched up 3% YoY (flat QoQ) to Rs 66.6k.

Lower commodity costs lift margin: Raw material cost adjusted for inventory increased 18% YoY (flat QoQ) to Rs 65.5bn, but declined to 67.3% of sales from 69.4%/68.6% in Q3FY23/Q2FY24 due to a benign commodity pricing environment. This led to gross margin gains of 210bps/125bps YoY/QoQ to 32.7%. Other expenses climbed 23%/14% YoY/QoQ growth to Rs 12.1bn due to festive season marketing expenses. EBITDA rose 47% YoY (+3% QoQ) to Rs 13.6bn and operating margin expanded 250bps YoY (flat QoQ) to 14%. Adj. PAT climbed 51% (+2% QoQ) to Rs 10.7bn backed by a 32% YoY gain in other income to Rs 2.4bn.

EV and premium portfolio expansion: Harley-Davidson X440 bookings stood at 30k+ units as of Q3, translating into revenue visibility for 3-4 months. Management expects production ramp-up of the X440 and Karizma XMR to ~10k units/month by Mar'24. HMCL launched Mavrick 440 and Xtreme 125R at its annual Hero World event, further expanding the premium portfolio. The company is planning a foray into EV motorcycles with the launch of three products in the performance, premium and mid-premium segments by FY26.

Positives priced in, retain HOLD: To factor in the healthy performance along with steady rural recovery and a premium segment focus, we raise our FY24/FY25 EBITDA/PAT estimates for HMCL by 4%/1% and 10%/6%. We also assign a higher 17x target P/E multiple (earlier 15x) to core operations – in line with the 10-year average – and roll valuations forward to FY26E. The higher multiple is to take cognizance of the better product basket, revival of rural demand and focus on EV segment. This gives us a new SOTP-based TP of Rs 4,671 (earlier Rs 3,009), which includes Rs 130/sh as the value of other businesses (unchanged). However, we believe current valuations bake in the positives and hence retain our HOLD rating.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	HMCL IN/Rs 4,909
Market cap	US\$ 11.9bn
Free float	65%
3M ADV	US\$ 37.4mn
52wk high/low	Rs 4,924/Rs 2,246
Promoter/FPI/DII	35%/30%/24%

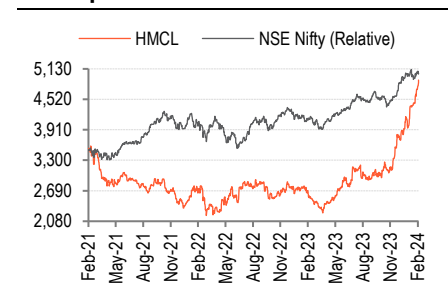
Source: NSE | Price as of 9 Feb 2024

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	3,38,057	3,89,963	4,53,665
EBITDA (Rs mn)	39,862	51,668	61,017
Adj. net profit (Rs mn)	29,106	39,628	45,795
Adj. EPS (Rs)	145.8	198.5	229.3
Consensus EPS (Rs)	145.8	199.5	228.0
Adj. ROAE (%)	17.4	22.4	23.1
Adj. P/E (x)	33.7	24.7	21.4
EV/EBITDA (x)	24.6	18.9	16.0
Adj. EPS growth (%)	17.7	36.2	15.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Earnings call highlights

Parameter	Q3FY24	Q2FY24	Our view
Volumes	<p>Volume contribution during the festive period in Q3FY24 was higher in rural areas as compared to urban markets.</p> <p>Management indicated that the 125cc segment continues to lead motorcycle industry volumes and expects momentum to continue in FY25. The >200cc segment has been the driver for the premium segment, and management expect double-digit growth here in FY25. The 125cc scooter segment continues to perform well in FY24 and management expects the growth momentum to continue in FY25</p> <p>Management expects double-digit growth for the 2W industry in FY25 and for HMCL to report growth higher than the industry on the back of new launches and investments.</p>	<p>Festive season volume growth stood at 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> volumes grew 2x YoY in Q2). HMCL has also 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>HMCL's two-fold strategy of retaining a strong presence in the lower segments while sharpening focus on the premium segment is showing early signs of paying off.</p>
Margins	<p>Operating margin expanded YoY because of a benign commodity pricing climate and better product and price positioning.</p> <p>ICE margins stood at ~16% despite a ~200bps drag from EV segment marketing.</p> <p>Management indicated that price hikes taken during Q3FY24 were in line with industry hikes.</p>	<p>Operating margin expanded as a result of softer commodity costs and a better product mix.</p> <p>ICE margins stood at ~15% despite 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>Realisation gains should continue from a better product mix. Softening costs are also aiding margin recovery, but realisations will remain the more important lever.</p>
Premiumisation	<p>Harley-Davidson <i>X440</i> bookings stood at 30k+ units as of Q3FY24, translating into revenue visibility for 3-4 months. Production ramp-up of <i>X440</i> and <i>Karizma XMR</i> to ~10k units/month is guided to occur by March.</p> <p>HMCL launched <i>Mavrick 440</i> and <i>Xtreme 125R</i>. Bookings for <i>Mavrick 440</i> will commence in February, followed by deliveries in April. Deliveries for <i>Xtreme 125R</i> are due to commence shortly.</p> <p>Hero 2.0 stores numbered at ~300 as of January and management expects ~400 stores by March this year and 500+ in FY25, along with ~100 Hero <i>Premia</i> stores.</p>	<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+ units.</p> <p>Management is looking to ramp up production of <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>We believe HMCL's strategy of targeting high-end products will help enhance margins. The company, however, is a late entrant in the premium segment and could face fierce competition from incumbents in the segment.</p>
Electric vehicles	<p>EV dealerships have now been expanded to 100+ cities and 150+ dealers. HMCL has ~18 Vida Hubs as on Q3FY24, which management expects to increase to 100 in FY25.</p> <p>HMCL expects the EV space to be occupied by scooters for the next few years, until battery technology changes, as the total ownership cost for EV motorcycles remains exceedingly high.</p> <p>HMCL will be foraying into the EV motorcycle segment by launching</p>	<p>EV production has been at >1k units per week for the last 3-4 weeks. Management expects to expand EV dealerships 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>The thrust on EVs is another positive step, though it may keep margins muted. Differentiated EV products have resulted in a healthy buyer response in the initial phase.</p>

Parameter	Q3FY24	Q2FY24	Our view
	performance motorcycles, followed by premium and mid-premium models by FY26.	HMCL enjoys a differentiated detachable battery structure compared to other companies who have a non-detachable structure.	
Others	<p>Revenue from the PAM segment during Q3FY24 stood at Rs 14.3bn.</p> <p>Other expenses grew 23% YoY to Rs 12.1bn driven by festive season marketing.</p> <p>Current inventory levels are back to 4-6 weeks and management expect similar levels for Q4FY24.</p> <p>Overall financing penetration as on Q3FY24 is ~60-65% and penetration for Hero Fincorp is ~30%.</p>	<p>Revenue from the PAM segment 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 of 4-6 weeks after the festive season.</p> <p>Receivables as on Q2FY24 stood at Rs 42.8bn due to extended credit to dealers on account of the festive season.</p>	Inventory and receivables are back to normal after traditionally staying high during the festive season. PAM segment contribution is likely to increase in the medium/long term.

Source: Company, BOBCAPS Research | 2W: Two-wheelers; ICE: Internal Combustion Engine; PAM: Parts, Accessories & Merchandise

Fig 2 – Quarterly performance (standalone)

(Rs mn)	Q3FY24	Q3FY23	YoY (%)	Q2FY24	QoQ (%)	9MFY24	9MFY23	YoY (%)
Volume	1,459,934	1,239,693	17.8	1,416,526	3.1	4,229,034	4,058,054	4.2
Avg. Realisation per Vehicle	66,604	64,782	2.8	66,680	(0.1)	66,059	62,835	5.1
Net Revenues	97,237	80,310	21.1	94,454	2.9	279,364	254,989	9.6
Total Income (A)	97,237	80,310	21.1	94,454	2.9	279,364	254,989	9.6
Operating Expenses:								
Raw materials consumed	65,470	55,743	17.5	64,780	1.1	191,059	182,118	4.9
Employee Expenses	6,017	5,456	10.3	5,768	4.3	17,586	16,328	7.7
Other Expenses	12,130	9,869	22.9	10,624	14.2	31,753	27,510	15.4
Total Expenditure (B)	83,617	71,068	17.7	81,171	3.0	240,399	225,956	6.4
EBITDA (A-B)	13,620	9,241	47.4	13,283	2.5	38,966	29,032	34.2
Other Income	2,420	1,832	32.1	2,483	(2.5)	7,125	3,282	117.1
Depreciation	1,825	1,620	12.7	1,749	4.4	5,264	4,884	7.8
EBIT	14,216	9,453	50.4	14,017	1.4	40,827	27,431	48.8
Finance Costs	45	49	(7.8)	48	(5.0)	139	152	(8.2)
PBT before exceptional items	14,170	9,404	50.7	13,970	1.4	40,688	27,279	49.2
Exceptional items	-	-	0.0	-	0.0	(1,600)	-	0.0
PBT after exceptional items	14,170	9,404	50.7	13,970	1.4	39,088	27,279	43.3
Tax expense	3,437	2,294	49.8	3,431	0.1	9,569	6,763	41.5
Reported PAT	10,734	7,111	51.0	10,538	1.9	29,519	20,517	43.9
Adjusted PAT	10,734	7,111	51.0	10,538	1.9	31,119	20,517	51.7
Adj EPS (Rs)	53.7	35.6	50.8	52.8	1.7	156	102.7	51.6
Key Ratios (%)			(bps)		(bps)			(bps)
Gross Margin	32.7	30.6	208	31	125	31.6	28.6	303
EBITDA Margin	14.0	11.5	250	14	(6)	13.9	11.4	256
EBIT Margin	14.6	11.8	285	15	(22)	14.6	10.8	386
PBT Margin	14.6	11.7	286	15	(22)	14.6	10.7	387
Tax Rate	24.3	24.4	(14)	25	(31)	24.5	24.8	(31)
Adj PAT Margin	11.0	8.9	218	11	(12)	11.1	8.0	309

Source: Company, BOBCAPS Research

Valuation methodology

To account for the healthy Q3FY24 performance along with steady rural demand recovery and HMCL's growing thrust on the premium segment, we increase our FY24/FY25 EBITDA estimates by 4%/1% and PAT forecasts by 10%/6%. We introduce FY26 projections for the company in this report and now model for a revenue/EBITDA/adj. PAT CAGR of 15%/21%/21% over FY23-FY26, with EBITDA margin averaging at 13-14%.

HMCL's focus on the high-end motorcycle segment augurs well to improve the quality of earnings and should help offset initial margin pressures from the EV foray. Further, rural segment revival benefits the company the most given its strong competency in the 125cc segment.

We now assign a higher 17x target P/E multiple (earlier 15x) to core operations – in line with the 10-year average – and roll valuations forward to FY26E. This gives us a new SOTP-based TP of Rs 4,671 (earlier Rs 3,009), which includes Rs 4,541/sh for the core business and Rs 130/sh as the value of other businesses (unchanged). However, we believe current valuations bake in the positives and hence retain our HOLD rating.

Fig 3 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	389,963	4,53,665	5,16,731	389,963	457,480	NA	1.0	(0.8)	NA
EBITDA	51,668	61,017	70,019	49,606	60,382	NA	4.2	1.1	NA
Adj PAT	39,630	45,794	51,993	36,131	43,386	NA	9.7	5.5	NA
Adj EPS (Rs)	198.5	229.3	260.4	180.9	217.3	NA	9.7	5.5	NA

Source: BOBCAPS Research

Fig 4 – Key assumptions

Parameter	FY23	FY24E	FY25E	FY26E
Volume (units)	53,28,546	58,54,013	64,85,986	71,72,458
Realisation (Rs/unit)	63,443	66,615	69,945	72,044
EBITDA (Rs mn)	39,862	51,668	61,017	70,019
EBITDA margin (%)	11.8	13.2	13.4	13.6
Adj. PAT (Rs mn)	29,106	39,630	45,794	51,993

Source: Company, BOBCAPS Research

Fig 5 – Valuation summary

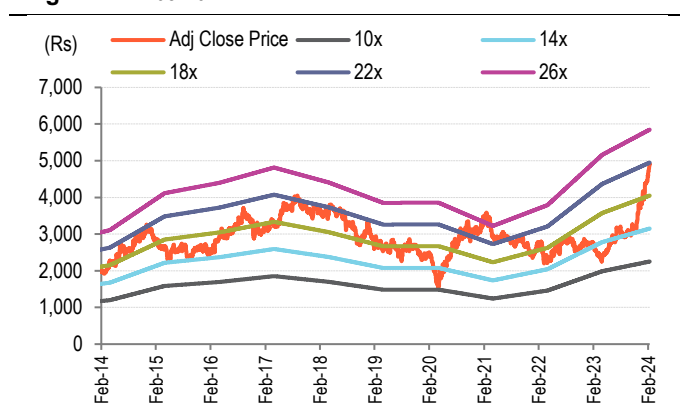
Business	FY26E EPS (Rs)	Target P/E (x)	Value (Rs)
Standalone Business	260	13	4,541
Other Business	-	-	130
Total	-	-	4,671

Source: BOBCAPS Research

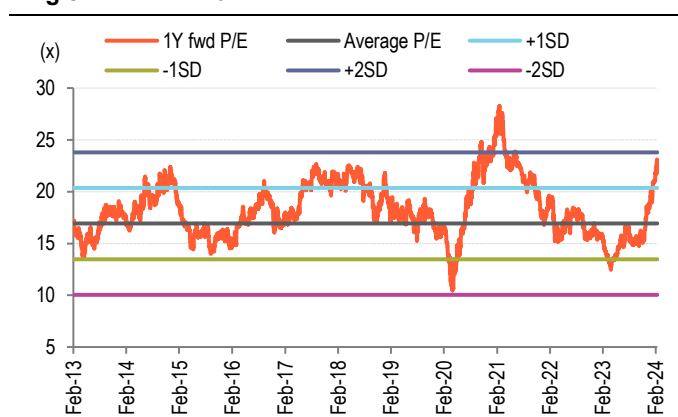
Fig 6 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	EPS (Rs)		ROE (%)	
				FY24E	FY25E	FY24E	FY25E
Hero Motocorp	HMCL IN	HOLD	4,671	198.5	229.3	23.1	24.4
TVS Motor Company	TVSL IN	BUY	2,242	43.0	60.7	26.1	27.6
Bajaj Auto	BJAUT IN	SELL	6,272	258.5	292.8	24.9	24.6

Source: BOBCAPS Research

Fig 7 – P/E band

Source: Bloomberg, BOBCAPS Research

Fig 8 – P/E 1Y fwd

Source: Bloomberg, BOBCAPS Research

Key risks

- A stronger response to HMCL's high-end products in the 150cc+ segment than expected would be a key upside risk to our estimates.
- Continued raw material cost inflation and slower-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	6.2	173	226	BUY
Bajaj Auto	BJAUT IN	27.4	7,785	6,272	SELL
Escorts	ESCORTS IN	4.5	2,807	2,389	SELL
Hero MotoCorp	HMCL IN	11.9	4,909	4,671	HOLD
Mahindra & Mahindra	MM IN	25.1	1,646	1,849	BUY
Maruti Suzuki	MSIL IN	39.4	10,733	12,234	BUY
TVS Motor	TVSL IN	11.8	2,038	2,242	BUY
VST Tillers Tractors	VSTT IN	0.3	3,102	3,213	HOLD

Source: BOBCAPS Research, NSE | Price as of 9 Feb 2024

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Total revenue	2,92,455	3,38,057	3,89,963	4,53,665	5,16,731
EBITDA	33,688	39,862	51,668	61,017	70,019
Depreciation	6,498	6,570	7,051	7,485	7,929
EBIT	32,759	38,944	52,382	60,915	69,185
Net interest inc./(exp.)	(258)	(199)	(240)	(259)	(319)
Other inc./(exp.)	5,569	5,652	7,765	7,383	7,094
Exceptional items	0	0	0	0	0
EBT	32,501	38,746	52,142	60,656	68,866
Income taxes	7,771	9,640	12,514	14,861	16,872
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	24,730	29,106	39,628	45,795	51,994
Adjustments	0	0	0	0	0
Adjusted net profit	24,730	29,106	39,628	45,795	51,994

Balance Sheet

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Accounts payables	44,498	49,638	59,843	69,786	75,861
Other current liabilities	7,595	8,151	8,559	8,987	9,436
Provisions	3,385	3,738	3,925	4,121	4,327
Debt funds	0	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	400	400	400	400	400
Reserves & surplus	1,57,429	1,66,651	1,76,227	1,98,059	2,22,097
Shareholders' fund	1,57,829	1,67,051	1,76,627	1,98,459	2,22,496
Total liab. and equities	2,13,307	2,28,578	2,48,953	2,81,353	3,12,121
Cash and cash eq.	1,751	3,455	2,199	2,002	4,236
Accounts receivables	23,043	27,982	31,197	36,293	42,372
Inventories	11,227	14,341	15,599	18,147	21,186
Other current assets	11,950	14,498	15,223	15,984	16,783
Investments	1,06,523	1,10,104	1,25,212	1,43,274	1,59,569
Net fixed assets	58,065	57,614	60,063	62,378	64,349
CWIP	4,582	4,638	3,400	7,000	7,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(3,833)	(4,054)	(3,939)	(3,724)	(3,374)
Other assets	0	0	0	0	0
Total assets	2,13,307	2,28,578	2,48,953	2,81,353	3,12,121

Cash Flows

Y/E 31 Mar (Rs mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash flow from operations	18,812	25,189	44,360	47,800	49,322
Capital expenditures	(4,894)	(6,175)	(8,262)	(13,400)	(9,900)
Change in investments	(1,526)	(3,580)	(15,109)	(18,061)	(16,296)
Other investing cash flows	5,569	5,652	7,765	7,383	7,094
Cash flow from investing	(852)	(4,104)	(15,605)	(24,078)	(19,102)
Equities issued/Others	106	71	(71)	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(258)	(199)	(240)	(259)	(319)
Dividends paid	(18,992)	(19,983)	(29,953)	(23,963)	(27,956)
Other financing cash flows	(208)	221	(114)	(215)	(350)
Cash flow from financing	(19,352)	(19,890)	(30,379)	(24,437)	(28,625)
Chg in cash & cash eq.	(1,391)	1,195	(1,624)	(715)	1,596
Closing cash & cash eq.	1,751	3,455	2,199	2,002	4,236

Per Share

Y/E 31 Mar (Rs)	FY22A	FY23A	FY24E	FY25E	FY26E
Reported EPS	123.8	145.8	198.5	229.3	260.4
Adjusted EPS	123.8	145.8	198.5	229.3	260.4
Dividend per share	95.1	100.1	150.0	120.0	140.0
Book value per share	790.4	836.6	884.5	993.8	1,114.2

Valuations Ratios

Y/E 31 Mar (x)	FY22A	FY23A	FY24E	FY25E	FY26E
EV/Sales	3.3	2.9	2.5	2.2	1.9
EV/EBITDA	29.0	24.6	18.9	16.0	14.0
Adjusted P/E	39.6	33.7	24.7	21.4	18.9
P/BV	6.2	5.9	5.5	4.9	4.4

DuPont Analysis

Y/E 31 Mar (%)	FY22A	FY23A	FY24E	FY25E	FY26E
Tax burden (Net profit/PBT)	76.1	75.1	76.0	75.5	75.5
Interest burden (PBT/EBIT)	99.2	99.5	99.5	99.6	99.5
EBIT margin (EBIT/Revenue)	11.2	11.5	13.4	13.4	13.4
Asset turnover (Rev./Avg TA)	188.0	208.1	226.9	241.9	245.5
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	16.0	17.9	23.1	24.4	24.7

Ratio Analysis

Y/E 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
YoY growth (%)					
Revenue	(5.0)	15.6	15.4	16.3	13.9
EBITDA	(16.2)	18.3	29.6	18.1	14.8
Adjusted EPS	(16.6)	17.7	36.2	15.6	13.5
Profitability & Return ratios (%)					
EBITDA margin	11.5	11.8	13.2	13.4	13.6
EBIT margin	11.2	11.5	13.4	13.4	13.4
Adjusted profit margin	8.5	8.6	10.2	10.1	10.1
Adjusted ROAE	15.7	17.4	22.4	23.1	23.4
ROCE	16.0	18.0	23.2	24.5	24.8
Working capital days (days)					
Receivables	30	28	28	27	28
Inventory	16	14	14	14	14
Payables	85	72	73	74	73
Ratios (x)					
Gross asset turnover	0.5	0.4	0.4	0.4	0.4
Current ratio	0.9	1.0	0.9	0.9	0.9
Net interest coverage ratio	(127.0)	(196.0)	(218.3)	(235.2)	(216.9)
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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Disclaimer

Name of the Research Entity: **BOB Capital Markets Limited**

Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

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

Brand Name: **BOBCAPS**

Trade Name: **www.barodaetrade.com**

CIN: **U65999MH1996GOI098009**



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

BUY – Expected return >+15%

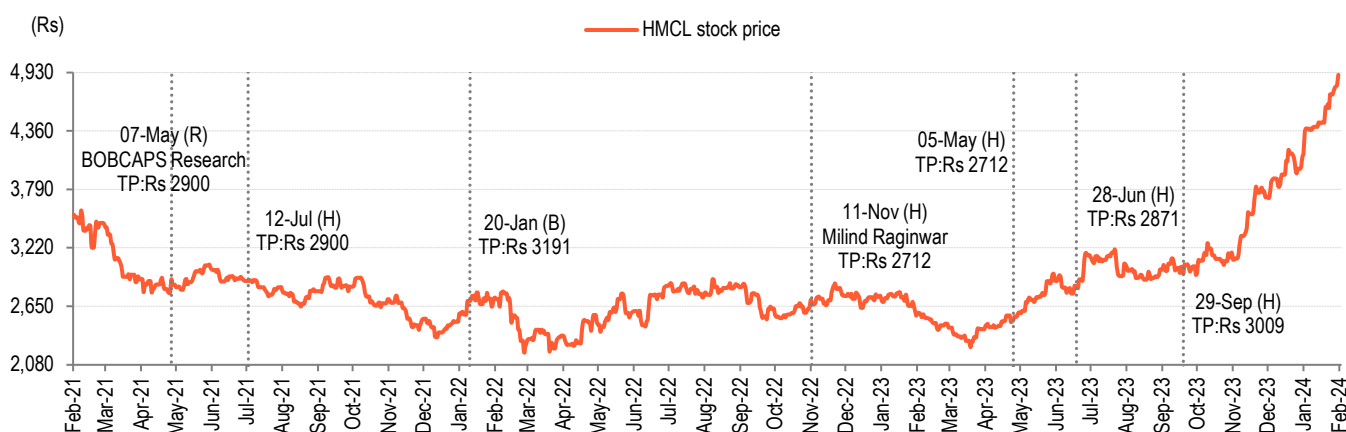
HOLD – Expected return from -6% to +15%

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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