

**HOLD**

TP: Rs 2,871 | ▲ 1%

**HERO MOTOCORP**

Automobiles

28 June 2023

## Management meet takeaways: Climbing on the premium bandwagon

- Upcoming launch of high-end 125cc motorcycle to help shore up market share (21% currently)
- Aggressive plans to roll out 4 premium vehicles over 4 quarters could help make amends for late entry into the high-end segment
- We raise FY24/FY25 EPS 2.0%/4% for a new SOTP-based TP of Rs 2,871 (vs. Rs 2,712); maintain HOLD

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**Targeting market share recovery in the core segment:** HMCL's launch pipeline for FY24 includes two motorcycles in its core 125cc segment in the sports and premium categories. This apart, its *X-tec* line (25% of FY23 volumes) caters to ongoing premiumisation trends. We expect customer-centric launches to strengthen HMCL's presence in the 125cc segment and aid revival in segmental market share which has contracted to 21% in FY23.

**Construction of premium portfolio and brands:** A total of four high-end two-wheeler launches are scheduled by the company over the next four quarters – two core and two upper premium. The brand's premium push will also be burnished by the popularity of Harley-Davidson. In partnership with the iconic brand, HMCL plans to unveil 100+ exclusive premium dealerships pan-India in FY24. Management hopes to bolster high-end sales by tapping young users and augmenting digital offerings.

**Enhancing its EV presence:** HMCL is looking to expand its *Vida* line of electric vehicles from FY25 which will be sold through *Vida* hubs (exclusive dealerships) and pods (Hero 2.0 and premium dealerships). The company aims to expand charging infrastructure and interoperability with Ather, the No. 2 EV player in the Indian market behind BJAUT. Management also intends to push e-commerce sales on platforms such as Flipkart and to launch new EV variants to mitigate competition.

**Cost optimisation and margin expansion plan:** HMCL's margin expansion plan revolves around extending its model-specific EBITDA programme, localising its supply chain, optimising plant opex, and reducing vehicle size (to lower material costs and also consumer operating cost, thereby raising popularity).

**Retain HOLD:** Following the new roadmap shared by HMCL, we raise our FY24/FY25 earnings estimates by 2%/4%. We now model for a revenue/EBITDA/adj. PAT CAGR of 15%/18%/18% over FY22-FY25 with EBITDA margin averaging at ~13%. The response to HMCL's aggressive premium launch programme and EV consolidation will yield results with a lag. Hence, we continue to value the core business at 13x FY25E EPS. Post estimate revision, our SOTP-based TP rises to Rs 2,871 (vs. Rs 2,712). HOLD.

## Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	HMCL IN/Rs 2,829
Market cap	US\$ 6.9bn
Free float	65%
3M ADV	US\$ 21.2mn
52wk high/low	Rs 3,026/Rs 2,246
Promoter/FPI/DII	35%/30%/24%

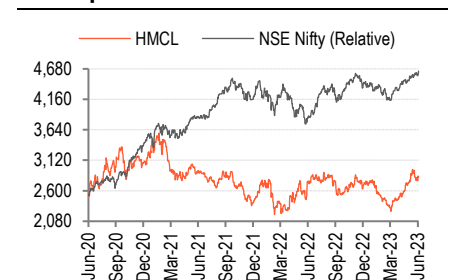
Source: NSE | Price as of 28 Jun 2023

## Key financials

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	3,38,057	3,86,660	4,46,034
EBITDA (Rs mn)	39,863	48,988	58,247
Adj. net profit (Rs mn)	29,107	35,582	41,691
Adj. EPS (Rs)	145.8	178.2	208.8
Consensus EPS (Rs)	145.8	177.0	197.0
Adj. ROAE (%)	17.5	19.5	20.4
Adj. P/E (x)	19.4	15.9	13.5
EV/EBITDA (x)	14.1	11.5	9.6
Adj. EPS growth (%)	17.7	22.2	17.2

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

## Stock performance



Source: NSE



## Other management meet takeaways

- **Revenue de-risking:** HMCL plans to de-risk revenue concentration in FY24 by increasing the share of the 125cc segment through two product launches.
- **Targeting first-time and younger buyers:** The company is targeting new as well as young customers by increasing financing availability (penetration has grown by 28% over FY20-FY23) and using data-driven digital marketing.
- **Enhanced digital focus and offerings:** Per management, digital enquires have doubled from FY21 to 10.6% in FY23 due to increased digitisation and digital preference amongst the youth. The company's 'One App' strategy of providing a single marketplace for digital retail finance, second-hand vehicles, parts, accessories and merchandise is expected to attract younger buyers and eventually boost revenue through ad monetisation.
- **Macro tailwinds:** Management believes that the global economy has largely recovered as rate cycles have peaked and supply chain and commodity pressures have eased. Expectations of a strong farming season in India are fuelling domestic rural demand. Further, the fall in income levels in HMCL's export markets due to the pandemic (primarily low-income LATAM, African and Asian countries) could raise buyer preference for two-wheelers as economic growth returns.
- **Capital allocation weighted toward premium/EV segments:** FY24 capex of Rs 15bn will be largely toward the premium and EV segments. Additionally, the company plans to hike spends for the digitisation platform by 50%. HMCL is in no hurry to increase its investment in Ather by taking a controlling stake. Instead, EV segment growth is targeted through acquisitions and joint ventures.
- **Declining traditional (ICE) scooter sales:** HMCL has dropped to fourth place in the domestic scooter market, with its share declining from 11% in FY19 to 6% in FY23. While domestic industry sales grew by 16% MoM in May, the company saw 8% contraction primarily due to a weaker brand image and product offerings than competitors.

## Valuation methodology

Factoring in the new launch and growth roadmap shared by HMCL, we raise our FY24/FY25 earnings estimates by 2%/4%. We now model for a revenue/EBITDA/adj. PAT CAGR of 15%/18%/18% over FY22-FY25E with EBITDA margin averaging at ~13%. Post estimate revision, our SOTP-based TP rises to Rs 2,871 (vs. Rs 2,712), with the standalone business valued at Rs 2,741/sh (13x FY25E EPS core business) and other segments at Rs 130/sh.

We maintain our HOLD rating as the response to HMCL's aggressive premium launch programme and consolidation of its EV presence will yield results with a lag. Also, though management has reiterated that the core segment (110cc-125cc) is its fastest growing, stiff competition and loss of market share remain key concerns in the medium term. Lastly, while the premium segment has grown at twice the rate of its other segments in the recent past, HMCL has been a late entrant and still needs to play catch up with peers.

**Fig 1 – Revised estimates**

(Rs mn)	New		Old		Change (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Revenue	3,86,660	4,46,034	3,82,719	4,39,853	1.0	1.4
EBITDA	48,988	58,247	48,969	56,675	0.0	2.8
Adj PAT	35,582	41,691	34,773	40,101	2.3	4.0
EPS (Rs)	178.2	208.8	174.1	200.8	2.3	4.0

Source: BOBCAPS Research

**Fig 2 – Key assumptions**

Parameter	FY22	FY23P	FY24E	FY25E
<b>Volume</b>	<b>49,44,132</b>	<b>53,30,171</b>	<b>58,13,208</b>	<b>63,32,743</b>
Realisation (Rs)	59,152	62,109	65,836	69,457
EBITDA (Rs mn)	5,569	3,851	4,501	5,082
EBITDA (%)	11.5	11.4	12.8	12.9
Adj PAT (Rs mn)	24,730	26,498	34,778	40,102
<b>EPS (Rs)</b>	<b>124</b>	<b>133</b>	<b>174</b>	<b>201</b>

Source: Company, BOBCAPS Research

**Fig 3 – Valuation summary**

Business	FY25E EPS (Rs)	Target P/E (x)	Value (Rs)
Standalone Business	209	13	2,741
Other Business	-	-	130
<b>Total</b>	<b>-</b>	<b>-</b>	<b>2,871</b>

Source: BOBCAPS Research

**Fig 4 – Peer comparison**

Company	Ticker	Rating	Target Price (Rs)	EPS (Rs)		ROE (%)	
				FY24E	FY25E	FY24E	FY25E
Hero Motocorp	HMCL IN	HOLD	2,712	178.2	208.8	20.4	21.6
TVS Motor Company	TVSL IN	HOLD	1,252	41.4	48.8	29.9	28.5
Bajaj Auto	BJAUT IN	HOLD	4,188	212	243	20.9	21.8

Source: 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	5.9	166	184	BUY
Bajaj Auto	BJAUT IN	16.6	4,716	4,188	HOLD
Eicher Motors	EIM IN	11.8	3,545	3,761	HOLD
Escorts	ESCORTS IN	3.5	2,195	1,749	SELL
Hero MotoCorp	HMCL IN	6.9	2,829	2,871	HOLD
Mahindra & Mahindra	MM IN	21.2	1,395	1,665	BUY
Maruti Suzuki	MSIL IN	35.1	9,541	9,858	HOLD
TVS Motor	TVSL IN	7.7	1,330	1,252	HOLD
VST Tillers Tractors	VSTT IN	0.3	2,807	3,218	BUY

Source: BOBCAPS Research, NSE | Price as of 28 Jun 2023

## Financials

### Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Total revenue</b>	<b>3,08,006</b>	<b>2,92,455</b>	<b>3,38,057</b>	<b>3,86,660</b>	<b>4,46,034</b>
EBITDA	40,193	33,688	39,863	48,988	58,247
Depreciation	6,769	6,498	6,570	7,469	8,383
EBIT	39,222	32,759	38,945	47,058	55,479
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	46,818	55,220
Income taxes	9,362	7,771	9,640	11,236	13,529
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
<b>Reported net profit</b>	<b>29,642</b>	<b>24,730</b>	<b>29,107</b>	<b>35,582</b>	<b>41,691</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>29,642</b>	<b>24,730</b>	<b>29,107</b>	<b>35,582</b>	<b>41,691</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
Accounts payables	52,046	44,498	48,236	50,982	57,223
Other current liabilities	8,913	7,595	7,975	8,374	8,792
Provisions	3,328	3,385	3,777	3,966	4,164
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	1,65,654	1,82,181	2,03,903
Shareholders' fund	1,51,984	1,57,829	1,66,054	1,82,580	2,04,302
<b>Total liab. and equities</b>	<b>2,17,570</b>	<b>2,13,307</b>	<b>2,26,041</b>	<b>2,45,902</b>	<b>2,74,482</b>
Cash and cash eq.	2,572	1,751	3,455	7,619	9,558
Accounts receivables	24,268	23,043	27,982	27,066	30,330
Inventories	14,696	11,227	14,341	13,920	15,611
Other current assets	6,601	11,950	12,983	13,632	14,314
Investments	1,04,997	1,06,523	1,10,104	1,23,104	1,41,104
Net fixed assets	59,884	58,065	59,385	61,417	61,034
CWIP	4,366	4,582	1,845	3,400	7,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(4,041)	(3,833)	(4,054)	(4,256)	(4,469)
Other assets	4,229	0	0	0	0
<b>Total assets</b>	<b>2,17,570</b>	<b>2,13,307</b>	<b>2,26,041</b>	<b>2,45,902</b>	<b>2,74,482</b>

### Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	FY24E	FY25E
<b>Cash flow from operations</b>	<b>42,251</b>	<b>18,812</b>	<b>25,248</b>	<b>41,294</b>	<b>45,421</b>
Capital expenditures	(6,435)	(4,894)	(5,153)	(11,055)	(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
<b>Cash flow from investing</b>	<b>(23,407)</b>	<b>(852)</b>	<b>(3,082)</b>	<b>(18,516)</b>	<b>(23,986)</b>
Equities issued/Others	131	106	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(218)	(258)	(199)	(240)	(259)
Dividends paid	(18,978)	(18,992)	(19,969)	(19,969)	(19,969)
Other financing cash flows	113	(208)	221	203	213
<b>Cash flow from financing</b>	<b>(18,953)</b>	<b>(19,352)</b>	<b>(19,947)</b>	<b>(20,006)</b>	<b>(20,015)</b>
<b>Chg in cash &amp; cash eq.</b>	<b>(109)</b>	<b>(1,391)</b>	<b>2,220</b>	<b>2,772</b>	<b>1,420</b>
<b>Closing cash &amp; cash eq.</b>	<b>2,572</b>	<b>1,751</b>	<b>3,455</b>	<b>7,619</b>	<b>9,558</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	148.4	123.8	145.8	178.2	208.8
Adjusted EPS	148.4	123.8	145.8	178.2	208.8
Dividend per share	95.0	95.1	100.0	100.0	100.0
Book value per share	761.1	790.4	831.6	914.3	1,023.1

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	1.8	1.9	1.7	1.5	1.2
EV/EBITDA	14.0	16.7	14.1	11.5	9.6
Adjusted P/E	19.1	22.8	19.4	15.9	13.5
P/BV	3.7	3.6	3.4	3.1	2.8

### DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23P	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	99.5
EBIT margin (EBIT/Revenue)	12.7	11.2	11.5	12.2	12.4
Asset turnover (Rev./Avg TA)	208.2	188.0	208.8	221.8	230.6
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
<b>Adjusted ROAE</b>	<b>20.2</b>	<b>16.0</b>	<b>18.0</b>	<b>20.4</b>	<b>21.6</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	6.8	(5.0)	15.6	14.4	15.4
EBITDA	1.5	(16.2)	18.3	22.9	18.9
Adjusted EPS	0.3	(16.6)	17.7	22.2	17.2
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	13.0	11.5	11.8	12.7	13.1
EBIT margin	12.7	11.2	11.5	12.2	12.4
Adjusted profit margin	9.6	8.5	8.6	9.2	9.3
Adjusted ROAE	19.5	15.7	17.5	19.5	20.4
ROCE	20.2	16.0	18.1	20.5	21.7
<b>Working capital days (days)</b>					
Receivables	24	30	28	26	23
Inventory	15	16	14	13	12
Payables	69	85	71	67	63
<b>Ratios (x)</b>					
Gross asset turnover	0.5	0.5	0.5	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)	(196.1)	(214.2)
<b>Adjusted debt/equity</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

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

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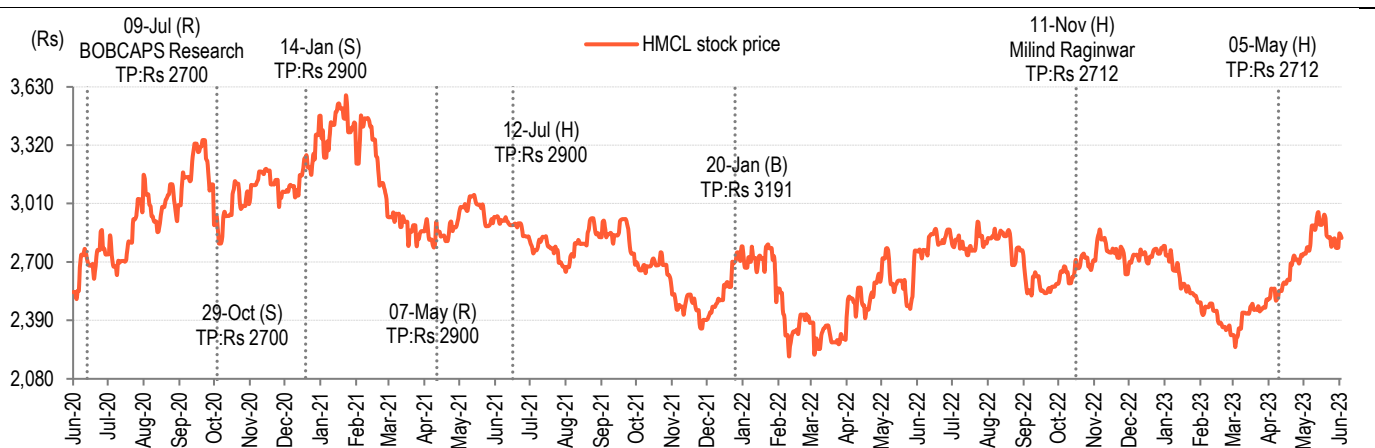
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**Note:** Recommendation structure changed with effect from 21 June 2021

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### 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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