

HOLD

TP: Rs 2,712 | ▲ 2%

HERO MOTOCORP

| Automobiles

| 11 November 2022

Efforts on to capture premium market

- Q2 revenue grew 7% YoY backed by realisation gains of 8%, which offset flat volumes on a weak base
- Gross margin was flat YoY at 28% as raw material cost remained high (but stabilised QoQ at 72% of sales)
- We assume coverage with HOLD given limited upside triggers; TP at Rs 2,712

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Revenue driven by higher ASP: HMCL reported Q2FY23 revenue growth of 7% YoY to Rs 90.8bn purely driven by a higher average selling price (ASP: Rs 63.5k, +8% YoY/+7% QoQ) on the back of an improved mix and price hikes. Volume growth was flat YoY and remains a concern. Raw material cost remained elevated, keeping gross margin flat YoY at 28%, but higher other expenses pulled EBITDA margin down to 11.4% (-120bps YoY) with EBITDA declining 3% YoY to Rs 10.4bn. This translated into a 10% YoY drop in PAT to Rs 7.2bn.

Demand push beyond pent-up volumes remains key: Q2 volumes grew % QoQ and retail sales climbed even higher by 20% due to pent-up demand post-Covid. While the revival in rural sentiment should be helpful, we believe HMCL will find it challenging to sustain volume growth. We pencil in a 9% uptick for each of the next two years.

Focus on premiumisation with launch of high-end models: Management indicated that it is focused on regaining lost market share in the 125cc+ segment. This will be through launches of 'X-Tec' variants in all key models, new model introductions in the premium space over the next 4-6 quarters, and product rollouts under its Harley Davidson tie-up.

Softening of key input costs to provide relief: Management indicated that metal prices are softening, which translated into relief of 30-40bps QoQ in raw material cost as a percentage of sales. Efforts to improve efficiencies and the easing of supply chain disruptions should be margin-accretive, though rupee depreciation and the energy cost spike are now key headwinds. HMCL did not proffer any margin guidance.

HOLD, TP Rs 2,712: We model for a revenue/EBITDA/adj. PAT CAGR of 9%/7%/2% over FY20-FY25, with EBITDA margin averaging at ~13%. Our FY23/FY24/FY25 EPS estimates stand at Rs 133/Rs 174/Rs 200, 10% lower than consensus on average as we build in softer gross margin assumptions. Valuing HMCL at 15x FY24E EPS – in line with its 10Y mean – and including Rs 100 as the value for other business, we arrive at an SOTP-based TP of Rs 2,712. We see limited upside triggers and hence recommend HOLD.

Key changes

Target	Rating
▼	▼

Ticker/Price	HMCL IN/Rs 2,669
Market cap	US\$ 6.6bn
Free float	65%
3M ADV	US\$ 20.9mn
52wk high/low	Rs 2,939/Rs 2,147
Promoter/FPI/DII	35%/30%/24%

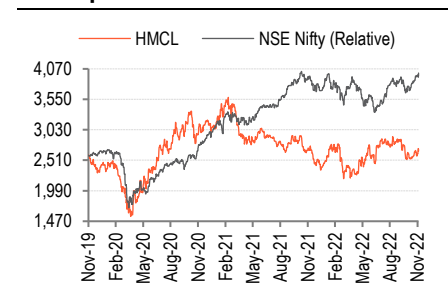
Source: NSE | Price as of 11 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	292,455	331,054	382,719
EBITDA (Rs mn)	33,688	37,778	48,969
Adj. net profit (Rs mn)	24,730	26,498	34,778
Adj. EPS (Rs)	123.8	132.7	174.2
Consensus EPS (Rs)	123.8	151.5	186.0
Adj. ROAE (%)	15.7	16.0	19.2
Adj. P/E (x)	21.5	20.1	15.3
EV/EBITDA (x)	15.7	14.1	10.9
Adj. EPS growth (%)	(16.6)	7.1	31.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Earnings call takeaways

- Management indicated that marketing activity picked up ahead of the Q2FY23 result season. Pent-up demand was strong post-pandemic and rural India provided healthy support. This translated into 20% QoQ growth in retail sales for the quarter.
- The Q2 model mix was favourable, as reflected in ASPs. HMCL is moving towards premiumisation – ‘Passion’ is doing well while the ‘Destiny’ and ‘Splendor’ models are also favoured by the market.
- Management indicated that raw material cost is cooling off as metal prices are softening, which translated into relief of 30-40bps QoQ. However, headwinds from rupee depreciation and the energy cost spike are likely to impact EBITDA margins.
- Receivables concerns only seasonal – per management, the rise was seasonal in nature and will normalise by the year-end as there has been no change in credit period (15-day interest-free period to dealers).
- Electric vehicles are well accepted but only at the premium end of the product range and in top cities. HMCL has 32% market share in the premium segment and intends to consolidate its leadership position.

Fig 1 – Quarterly performance (Standalone)

(Rs mn)	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	H1FY22	H1FY23	YoY (%)
Volume	1,428,168	1,438,623	(0.7)	1,390,193	2.7	2,463,112	2,818,361	(12.6)
Avg. Realisation per Vehicle	63,545	58,760	8.1	60,370	5.3	61	35	74.7
Net Revenues	90,754	84,534	7.4	83,925	8.1	112,319	123,915	(9.4)
Total Income (A)	90,754	84,534	7.4	83,925	8.1	6	4	58.6
Operating Expenses:						75	60	
Raw materials consumed	65,301	61,104	6.9	61,074	6.9	17	32	(45.7)
Employee Expenses	5,490	5,054	8.6	5,382	2.0	(1,427)	282	(606.2)
Other Expenses	9,579	7,712	24.2	8,062	18.8	102,326	126,093	(18.8)
Total Expenditure (B)	80,370	73,870	8.8	74,518	7.9	145	145	0.1
EBITDA (A-B)	10,383	10,664	(2.6)	9,408	10.4	19	37	(50.2)
Other Income	921	1,569	(41.3)	530	73.7	9,411	10,872	(13.4)
Depreciation	1,634	1,639	(0.3)	1,630	0.2	14	12	11.7
EBIT	9,670	10,594	(8.7)	8,308	16.4	13,282	17,641	(24.7)
Finance Costs	33	65	(49.4)	70	(52.6)	19	20	(4.4)
PBT before excep items	9,637	10,529	(8.5)	8,238	17.0	123,593	154,888	(20.2)
Exceptional items	-	-				15,812	19,791	(20.1)
PBT after excep items	9,637	10,529	(8.5)	8,238	17.0	359	80	348.6
Tax expense	2,476	2,585	(4.2)	1,993	24.2	50	31	60.2
Reported PAT	7,161	7,944	(9.9)	6,245	14.7	22	23	(2.9)
Adjusted PAT	7,161	7,944	(9.9)	6,245	14.7	2,955	1,450	103.8
Adj EPS (Rs)	31.4	39.8	(21.1)	31.3	0.4	126	103	22.7
	Q2FY23	Q2FY22	(bps)	Q1FY23	(bps)			
Gross Margin (%)	28.0	27.7	33.8	27.2	81.7			
EBITDA Margin (%)	11.4	12.6	(117.4)	11.2	23.1			
EBIT Margin (%)	10.7	12.5	(187.8)	9.9	75.6			
PBT Margin (%)	10.6	12.5	(183.7)	9.8	80.3			
Tax Rate (%)	25.7	24.5	114.3	24.2	150.2			
Adj PAT Margin (%)	7.9	9.4	(150.7)	7.4	44.9			

Source: Company, BOBCAPS Research

Valuation methodology

We model for a revenue/EBITDA/adj. PAT CAGR of 9%/7%/ 2% over FY20-FY25, with EBITDA margin averaging at ~13%. Our FY23/FY24/ FY25 EPS estimates stand at Rs 133/Rs 174/Rs 200, 10% lower than consensus on average as we build in softer gross margin assumptions. Valuing HMCL at 15x FY24E EPS – in line with its 10-year mean – and including Rs 100 as the value for other business, we arrive at an SOTP-based TP of Rs 2,712. With limited upside triggers and the absence of key negatives, we believe valuations will remain range-bound and hence recommend HOLD.

Fig 2 – Key assumptions

Parameter	FY22	FY23E	FY24E	FY24E
Vol	4,944,132	5,330,171	5,813,208	6,332,743
Realisation	59,152	62,109	65,836	69,457
EBITDA	33,688	37,778	48,969	56,675
OPM (%)	12.0	11.4	12.8	12.9
Adj PAT	24,730	26,498	34,778	40,102
EPS (Rs)	124	133	174	201

Source: Company, BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- faster response to the company's premiumisation efforts,

Key downside risks are:

- protracted raw material cost inflation, and
- later-than-expected demand revival, especially from the rural segment.

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	308,006	292,455	331,054	382,719	439,853
EBITDA	40,193	33,688	37,778	48,969	56,675
Depreciation	6,769	6,498	6,543	7,469	8,383
EBIT	39,222	32,759	35,086	46,001	53,375
Net interest inc./(exp.)	(218)	(258)	(220)	(240)	(259)
Other inc./(exp.)	5,799	5,569	3,851	4,501	5,082
Exceptional items	0	0	0	0	0
EBT	39,004	32,501	34,866	45,761	53,116
Income taxes	9,362	7,771	8,368	10,983	13,013
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	29,642	24,730	26,498	34,778	40,102
Adjustments	0	0	0	0	0
Adjusted net profit	29,642	24,730	26,498	34,778	40,102

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	52,046	44,498	47,278	50,656	56,845
Other current liabilities	8,913	7,595	7,975	8,374	8,792
Provisions	3,328	3,385	3,554	3,732	3,918
Debt funds	0	0	0	0	0
Other liabilities	1,298	0	0	0	0
Equity capital	400	400	400	400	400
Reserves & surplus	151,585	157,429	164,957	180,765	200,899
Shareholders' fund	151,984	157,829	165,357	181,165	201,298
Total liab. and equities	217,570	213,307	224,163	243,926	270,854
Cash and cash eq.	2,572	1,751	2,125	2,570	2,683
Accounts receivables	24,268	23,043	24,829	26,790	29,910
Inventories	14,696	11,227	11,587	13,778	15,395
Other current assets	6,601	11,950	12,547	13,175	13,833
Investments	104,997	106,523	113,523	126,523	144,523
Net fixed assets	59,884	58,065	59,385	61,417	61,034
CWIP	4,366	4,582	4,000	3,400	7,000
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(4,041)	(3,833)	(3,833)	(3,726)	(3,525)
Other assets	4,229	0	0	0	0
Total assets	217,570	213,307	224,163	243,926	270,854

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	42,251	18,812	29,554	36,681	44,543
Capital expenditures	(6,435)	(4,894)	(7,281)	(8,900)	(11,600)
Change in investments	(22,770)	(1,526)	(7,000)	(13,000)	(18,000)
Other investing cash flows	5,799	5,569	3,851	4,501	5,082
Cash flow from investing	(23,407)	(852)	(10,430)	(17,399)	(24,518)
Equities issued/Others	131	106	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(218)	(258)	(220)	(240)	(259)
Dividends paid	(18,978)	(18,992)	(18,970)	(18,970)	(19,969)
Other financing cash flows	113	(208)	0	(107)	(202)
Cash flow from financing	(18,953)	(19,352)	(19,190)	(19,317)	(20,429)
Chg in cash & cash eq.	(109)	(1,391)	(66)	(35)	(404)
Closing cash & cash eq.	2,572	1,751	2,125	2,570	2,683

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	148.4	123.8	132.7	174.2	200.8
Adjusted EPS	148.4	123.8	132.7	174.2	200.8
Dividend per share	95.0	95.1	95.0	95.0	100.0
Book value per share	761.1	790.4	828.1	907.2	1,008.1

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	1.7	1.8	1.6	1.4	1.2
EV/EBITDA	13.2	15.7	14.1	10.9	9.4
Adjusted P/E	18.0	21.5	20.1	15.3	13.3
P/BV	3.5	3.4	3.2	2.9	2.6

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	76.0	76.1	76.0	76.0	75.5
Interest burden (PBT/EBIT)	99.4	99.2	99.4	99.5	99.5
EBIT margin (EBIT/Revenue)	12.7	11.2	10.6	12.0	12.1
Asset turnover (Rev./Avg TA)	208.2	188.0	204.9	220.9	230.0
Leverage (Avg TA/Avg Equity)	1.0	1.0	1.0	1.0	1.0
Adjusted ROAE	20.2	16.0	16.4	20.1	21.0

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	6.8	(5.0)	13.2	15.6	14.9
EBITDA	1.5	(16.2)	12.1	29.6	15.7
Adjusted EPS	0.3	(16.6)	7.1	31.2	15.3
Profitability & Return ratios (%)					
EBITDA margin	13.0	11.5	11.4	12.8	12.9
EBIT margin	12.7	11.2	10.6	12.0	12.1
Adjusted profit margin	9.6	8.5	8.0	9.1	9.1
Adjusted ROAE	19.5	15.7	16.0	19.2	19.9
ROCE	20.2	16.0	16.5	20.2	21.1
Working capital days (days)					
Receivables	24	30	26	25	24
Inventory	15	16	13	12	12
Payables	69	85	70	66	63
Ratios (x)					
Gross asset turnover	0.5	0.5	0.5	0.4	0.4
Current ratio	0.7	0.9	0.9	0.9	0.9
Net interest coverage ratio	(179.6)	(127.0)	(159.5)	(191.7)	(206.1)
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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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

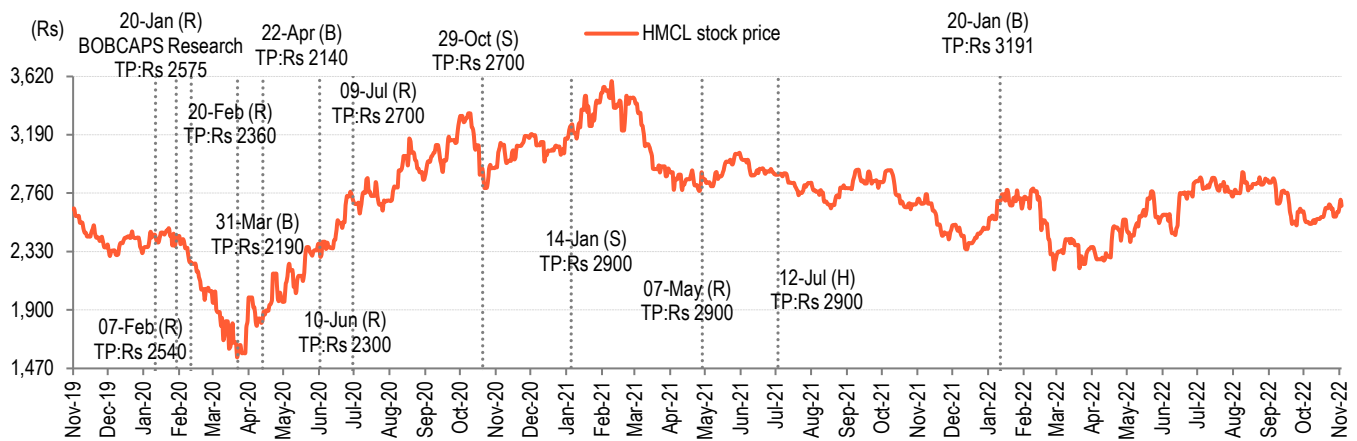
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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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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