

**HOLD**

TP: Rs 2,712 | ▲ 6%

**HERO MOTOCORP**

| Automobiles

| 05 May 2023

**Improved performance; sustainability to be seen**

- Q4 revenue grew 12% YoY backed by 5% higher net realisation per vehicle and volume gains of 7%
- Gross margin improved 132bps YoY to 32% largely due to easing of raw material price, price pass thru only
- We value HMCL at 13x (15x) as we rollover valuations over to FY25 with at TP of Rs 2,712 (unchanged) Maintain HOLD.

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**Healthy volumes and realisations:** HMCL's Q4FY23 revenue grew 12% YoY (+3% QoQ) to Rs 83bn as volumes increased by 7% (+2.5% QoQ) to 1.3mn units. Despite the volume push, net realisation per vehicle (NRPV) grew 5% YoY (+1% QoQ) to Rs 65.4k.

**Operating leverage aids margin improvement:** Raw material cost (adjusted to inventory jumped) 10%/1% YoY/QoQ and as % of sales was at 68% vs 69.3% in Q4FY22, aiding gross margin improvement of 132bps YoY (+144bps QoQ) to 32% Operating leverage on other expenses (70-80bps) and leap cost savings initiatives further aided EBITDA margin gains. EBITDA increased 31% YoY (+17% QoQ) to Rs 10.8bn with margin expansion of 189bps YoY (+153bps QoQ) to 13%. Other expenditure grew by 5%/3% YoY/QoQ at Rs 10.2bn. Adj. PAT climbed 37% YoY (+21% QoQ) to Rs 8.6bn further backed by a 70% surge in other income to Rs 2.4bn (+29% QoQ).

**Focus on launches:** Management indicated aggressive new launches across segments in every quarter of FY24. Further, the focus will be on recovery in the 125cc segment, building the premium portfolio and improving market share.

**Rural demand picking up:** Rural demand witnessed an uptick in the month of March on account of festivals, and management expects the growth momentum to continue in the wake of the wedding season and anticipates well-balanced growth across segments. Retail finance penetration has risen to 59%, which is further aiding volume growth.

**Retain HOLD:** We model for a revenue/EBITDA/adj. 15%/19%/17% for HMCL over FY22-FY25, with EBITDA margin averaging at ~13%. Our FY24/FY25 EPS remains at Rs 174/Rs 200. we await rural recovery, export market revival and the response to HMCL's aggressive launch programme before upgrading our estimates. We reset our target P/E multiple from 15 to 13x as we rollover valuations over to FY25 (earlier FY24), our SOTP-based TP remains unchanged at Rs 2,712, offering 6% upside. Maintain HOLD.

**Key changes**

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	HMCL IN/Rs 2,547
Market cap	US\$ 6.2bn
Free float	65%
3M ADV	US\$ 14.1mn
52wk high/low	Rs 2,939/Rs 2,246
Promoter/FPI/DII	35%/30%/24%

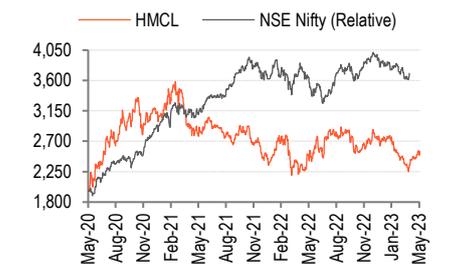
Source: NSE | Price as of 5 May 2023

**Key financials**

Y/E 31 Mar	FY23P	FY24E	FY25E
Total revenue (Rs mn)	3,38,057	3,82,719	4,39,853
EBITDA (Rs mn)	39,862	48,969	56,675
Adj. net profit (Rs mn)	29,105	34,773	40,101
Adj. EPS (Rs)	145.8	174.1	200.8
Consensus EPS (Rs)	145.8	173.8	194.5
Adj. ROAE (%)	17.4	18.9	19.7
Adj. P/E (x)	17.5	14.6	12.7
EV/EBITDA (x)	12.7	10.3	8.8
Adj. EPS growth (%)	17.7	19.5	15.3

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

**Stock performance**



Source: NSE



**Fig 1 – Earnings call highlights**

Parameter	Q4FY23	Q3FY23	Our view
Market share	<p>HMCL's 2W market share grew 3% QoQ and 2% YoY; motorcycle share was 51%.</p> <p>Market share in the 125cc segment increased to 22% from 14% with a target of 50% over the next two years.</p> <p>HMCL has 7-8% market share in the ICE scooter portfolio.</p>	<p>Management aims to regain 125cc market share, for which multiple launches are lined up, not only for the coming year but for the next 3-5 years.</p> <p>HMCL's scooter market share grew from 6% to 9%.</p>	Retention of leadership in the lower end 100cc bikes is key. HMCL has an aggressive plan to build presence in higher end bikes but faces stiff competition.
Margins	<p>EBITDA margin recovered by close to 200bps YoY, of which 70-80bps was on account of operating leverage and the rest came from Project Leap savings, commodity softening and price hikes. Management does not expect any escalation in commodity prices.</p> <p>Pricing increased by ~Rs 4,000 per vehicle for FY23 and a further Rs 600 in April.</p> <p>Management gave out longer term margin guidance of 14-16%.</p>	<p>Margins improved on the back of price hikes (Aug: Rs 300, Sep: Rs 500, Dec: Rs 930), Project Leap savings (80bps over 9M) and commodity softening (150-200bps YoY).</p> <p>Management indicated that price hikes related to OBD2 norms are not material and are expected to be in the range of Rs 500 to Rs 800 per vehicle.</p>	Margin recovery though welcome is limited only to passthrough of higher costs. The trigger will be margin accretion and reaching the previous high trajectory.
Premiumisation	HMCL's premium motorcycle segment (150cc+) has grown 28% in FY23 vs. category growth of 14%.	Management aims to build meaningful premium segment market share in the medium term.	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	Prices of <i>Vida</i> were revised down to boost demand; this model is currently available in 8 cities and will be taken to 100 cities in FY24. At present, management sees no capacity constraints for EV ramp-up.	During the quarter, HMCL commenced deliveries of <i>Vida</i> and is now present in three cities.	EV plans are aggressive and face competition.
Exports	HMCL derived 5% of volumes from exports (vs. 25% for the industry) and expects to scale this up to 10-15% of revenue in the medium term.	Global business is targeted to contribute at least 10% of overall revenue over the medium to long term.	Export turnaround will have to wait given global weakness; however, this is an industrywide issue.
Others	<p>Management expects double-digit revenue growth for the 2W industry in FY24.</p> <p>Spares revenue stood at Rs 12.7 against Rs 11.5bn in Q4FY22.</p> <p>Export revenue for FY23 was Rs 11.5bn.</p>	Spares revenue was at Rs 12.6bn vs. Rs 11.9bn in Q3FY22.	Other revenue streams are steady.

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

**Fig 2 – Quarterly performance**

(Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Volume	1,270,492	1,188,884	6.9	1,239,693	2.5	5,328,546	4,944,132	7.8
Avg. Realisation per Vehicle	65,382	62,426	4.7	64,782	0.9	63,443	59,152	7.3
Net Revenues	83,068	74,217	11.9	80,310	3.4	338,057	292,455	15.6
<b>Total Income (A)</b>	<b>83,068</b>	<b>74,217</b>	<b>11.9</b>	<b>80,310</b>	<b>3.4</b>	<b>338,057</b>	<b>292,455</b>	<b>15.6</b>
<b>Operating Expenses:</b>								
Raw materials consumed	56,463	51,424	9.8	55,743	1.3	238,581	208,267	14.6
Employee Expenses	5,571	4,763	16.9	5,456	2.1	21,898	19,354	13.1
Other Expenses	10,204	9,754	4.6	9,869	3.4	37,715	31,145	21.1
<b>Total Expenditure (B)</b>	<b>72,238</b>	<b>65,942</b>	<b>9.5</b>	<b>71,068</b>	<b>1.6</b>	<b>298,194</b>	<b>258,767</b>	<b>15.2</b>
<b>EBITDA (A-B)</b>	<b>10,830</b>	<b>8,276</b>	<b>30.9</b>	<b>9,241</b>	<b>17.2</b>	<b>39,862</b>	<b>33,688</b>	<b>18.3</b>
Other Income	2,369	1,398	69.5	1,832	29.3	5,652	5,569	1.5
Depreciation	1,686	1,585	6.4	1,620	4.1	6,570	6,498	1.1
EBIT	11,513	8,089	42.3	9,453	21.8	38,944	32,759	18.9
Finance Costs	47	67	(29.7)	49	(4.5)	199	258	(23.0)
PBT before exceptional items	11,467	8,022	42.9	9,404	21.9	38,746	32,501	19.2
Exceptional items	-	-	-	-	-	-	-	-
PBT after exceptional items	11,467	8,022	42.9	9,404	21.9	38,746	32,501	19.2
Tax expense	2,877	1,752	64.3	2,294	25.4	9,640	7,771	24.0
Reported PAT	8,589	6,271	37.0	7,111	20.8	29,106	24,730	17.7
<b>Adjusted PAT</b>	<b>8,589</b>	<b>6,271</b>	<b>37.0</b>	<b>7,111</b>	<b>20.8</b>	<b>29,106</b>	<b>24,730</b>	<b>17.7</b>
Adj EPS (Rs)	43.0	31.4	37.0	35.6	20.8	146	123.9	17.7
<b>Key Ratios (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
Gross Margin	32.0	30.7	132	30.6%	144	29.4	28.8	64
EBITDA Margin	13.0	11.2	189	11.5%	153	11.8	11.5	27
EBIT Margin	13.9	10.9	296	11.8%	209	11.5	11.2	32
PBT Margin	13.8	10.8	299	11.7%	209	11.5	11.1	35
Tax Rate	25.1	21.8	326	24.4%	70	24.9	23.9	97
Adj PAT Margin	10.3	8.4	189	8.9%	149	8.6	8.5	15

Source: Company, BOBCAPS Research

## Valuation methodology

We model for a revenue/EBITDA/adj. PAT CAGR of 15%/19%/17% for HMCL over FY22-FY25, with EBITDA margin averaging at ~13%. Our FY24/FY25 EPS remains at Rs 174/Rs 200. We await rural recovery, export market revival and the response to HMCL's aggressive launch programme before upgrading our estimates. We reset our target P/E multiple from 15 to 13x as we rollover valuations over to FY25 (earlier FY24), our SOTP-based TP remains unchanged at Rs 2,712, offering 6% upside. Maintain HOLD.

**Fig 3 – Key assumptions**

Parameter	FY22	FY23	FY24E	FY25E
Volume	4,944,132	5,328,546	5,813,208	6,332,743
Realisation (Rs)	59,152	63,443	65,836	69,457
EBITDA (Rs)	33,688	39,862	48,969	56,675
EBITDA margin (%)	11.5	11.8	12.8	12.9
Adj. PAT (Rs)	24,730	29,106	34,778	40,102
EPS (Rs)	124	146	174	201

Source: Company, BOBCAPS Research

**Fig 4 – Valuation summary**

Business	FY25E EPS (Rs)	Target P/E (x)	Value (Rs)
Standalone Business	201	13	2,612
Other Business	-	-	100
<b>Total</b>	-	-	<b>2,712</b>

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	2,712	174.1	200.8	19.8	20.7
TVS Motor Company	TVSL IN	HOLD	1,252	41.4	48.8	29.9	28.5
Bajaj Auto	BJAUT IN	HOLD	4,188	212.0	243.0	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	5.2	145	169	BUY
Bajaj Auto	BJAUT IN	15.8	4,463	4,188	HOLD
Eicher Motors	EIM IN	11.2	3,355	3,543	HOLD
Escorts	ESCORTS IN	3.4	2,067	1,742	SELL
Hero MotoCorp	HMCL IN	6.2	2,547	2,712	HOLD
Mahindra & Mahindra	MM IN	18.5	1,211	1,496	BUY
Maruti Suzuki	MSIL IN	33.1	8,949	9,858	HOLD
TVS Motor	TVSL IN	7.1	1,215	1,252	HOLD
VST Tillers Tractors	VSTT IN	0.3	2,426	2,802	BUY

Source: BOBCAPS Research, NSE | Price as of 5 May 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>3,82,719</b>	<b>4,39,853</b>
EBITDA	40,193	33,688	39,862	48,969	56,675
Depreciation	6,769	6,498	6,570	7,469	8,383
EBIT	39,222	32,759	38,944	45,993	53,373
Net interest inc./(exp.)	(218)	(258)	(199)	(240)	(259)
Other inc./(exp.)	5,799	5,569	5,652	4,493	5,081
Exceptional items	0	0	0	0	0
EBT	39,004	32,501	38,745	45,753	53,114
Income taxes	9,362	7,771	9,640	10,981	13,013
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>29,105</b>	<b>34,773</b>	<b>40,101</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>29,642</b>	<b>24,730</b>	<b>29,105</b>	<b>34,773</b>	<b>40,101</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23P	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	3,738	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	1,83,367	2,03,499
Shareholders' fund	1,51,984	1,57,829	1,67,051	1,83,766	2,03,898
<b>Total liab. and equities</b>	<b>2,17,570</b>	<b>2,13,307</b>	<b>2,26,041</b>	<b>2,46,721</b>	<b>2,73,657</b>
Cash and cash eq.	2,572	1,751	3,455	8,856	9,370
Accounts receivables	24,268	23,043	27,982	26,790	29,910
Inventories	14,696	11,227	14,341	13,778	15,395
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>2,46,721</b>	<b>2,73,657</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>24,250</b>	<b>42,578</b>	<b>44,530</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	4,493	5,081
<b>Cash flow from investing</b>	<b>(23,407)</b>	<b>(852)</b>	<b>(3,082)</b>	<b>(19,562)</b>	<b>(24,519)</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)	(18,970)	(18,970)	(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>(18,948)</b>	<b>(19,008)</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>4,008</b>	<b>(4)</b>
<b>Closing cash &amp; cash eq.</b>	<b>2,572</b>	<b>1,751</b>	<b>3,455</b>	<b>8,856</b>	<b>9,370</b>

### Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23P	FY24E	FY25E
Reported EPS	148.4	123.8	145.8	174.1	200.8
Adjusted EPS	148.4	123.8	145.8	174.1	200.8
Dividend per share	95.0	95.1	95.0	95.0	100.0
Book value per share	761.1	790.4	836.6	920.3	1,021.1

### Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23P	FY24E	FY25E
EV/Sales	1.6	1.7	1.5	1.3	1.1
EV/EBITDA	12.6	15.0	12.7	10.3	8.8
Adjusted P/E	17.2	20.6	17.5	14.6	12.7
P/BV	3.3	3.2	3.0	2.8	2.5

### 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	12.0	12.1
Asset turnover (Rev./Avg TA)	208.2	188.0	208.1	218.2	226.9
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>17.9</b>	<b>19.8</b>	<b>20.7</b>

### Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23P	FY24E	FY25E
<b>YoY growth (%)</b>					
Revenue	6.8	(5.0)	15.6	13.2	14.9
EBITDA	1.5	(16.2)	18.3	22.8	15.7
Adjusted EPS	0.3	(16.6)	17.7	19.5	15.3
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	13.0	11.5	11.8	12.8	12.9
EBIT margin	12.7	11.2	11.5	12.0	12.1
Adjusted profit margin	9.6	8.5	8.6	9.1	9.1
Adjusted ROAE	19.5	15.7	17.4	18.9	19.7
ROCE	20.2	16.0	18.0	19.9	20.8
<b>Working capital days (days)</b>					
Receivables	24	30	28	26	24
Inventory	15	16	14	13	12
Payables	69	85	70	66	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)	(191.6)	(206.1)
<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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### Recommendation scale: Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

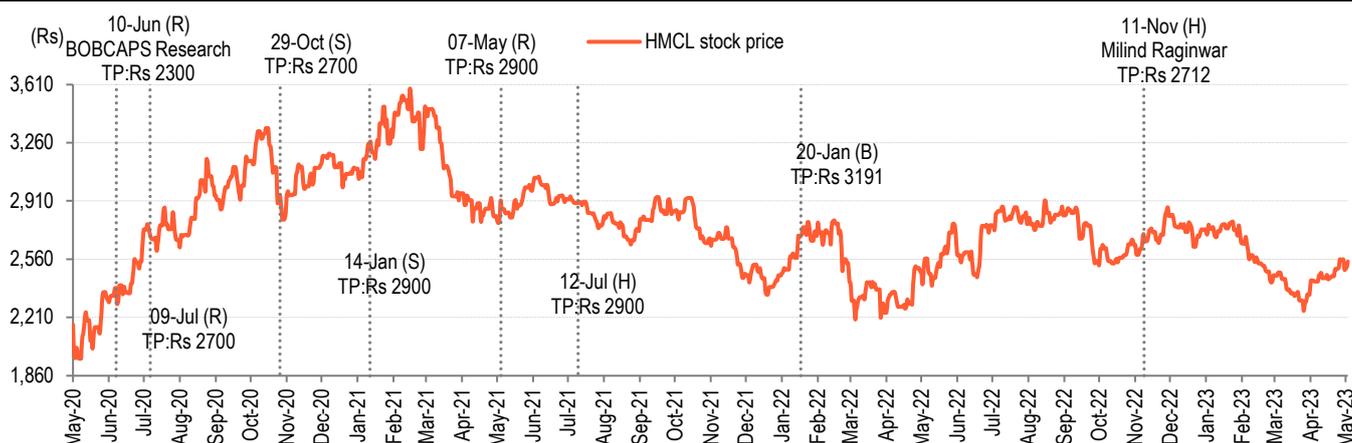
**HOLD** – Expected return from -6% to +15%

**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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