



TM

11 February 2022

Hero MotoCorp

EBITDA margin surprises positively

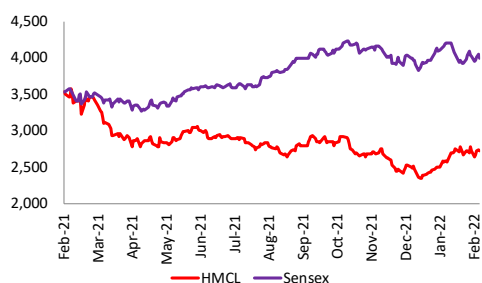
| RESULT UPDATE | |
|----------------------|-------------------------------|
| Sector: Auto | Rating: BUY |
| CMP: Rs 2,734 | Target Price: Rs 3,342 |

| Stock Info | |
|------------------------|--------------------|
| Sensex/Nifty | 60,686 / 18,103 |
| Bloomberg | HMCL IN |
| Equity shares (mn) | 200 |
| 52-wk High/Low | Rs 3,628/2,310 |
| Face value | Rs 2 |
| M-Cap (Rs bn)/(USD bn) | Rs 546bn/USD 7.3bn |
| 3-m Avg volume | USD 22mn |

| Financial Snapshot (Rs mn) | | | |
|----------------------------|----------|----------|----------|
| Y/E Mar | FY22E | FY23E | FY24E |
| Volume growth (%) | -10 | 13 | 9 |
| Net Sales | 3,04,258 | 3,43,536 | 3,71,236 |
| EBIDTA | 36,009 | 42,374 | 46,528 |
| PAT | 27,089 | 32,214 | 35,696 |
| EPS (Rs) | 136 | 161 | 179 |
| PE (x) | 20.1 | 16.9 | 15.2 |
| EV/EBITDA (x) | 12.5 | 10.4 | 9.3 |
| RoE (%) | 17 | 19 | 20 |
| RoCE (%) | 22 | 25 | 25 |
| FCF yield | 2.7 | 4.6 | 4.8 |
| Dividend yield (%) | 3.3 | 3.7 | 3.7 |

| Shareholding Pattern (%) | | | |
|--------------------------|--------|--------|--------|
| | Dec'21 | Sep'21 | Jun'21 |
| Promoter | 34.8 | 34.8 | 34.8 |
| -Pledged | - | - | - |
| FII | 29.6 | 32.3 | 35.0 |
| DII | 23.7 | 22.0 | 20.2 |
| Others | 11.9 | 10.9 | 10.0 |

Stock Performance (1-year)



Hero MotoCorp (Hero)'s 3QFY22 operational performance was in-line with consensus and our estimates, with gross margin expansion offset by high other expenses. The management expects domestic 2W demand to recover with the re-opening of schools/colleges and improving rural income levels. In EVs, it has a three-pronged strategy of 1) investment in Ather – a premium scooter offering, 2) in-house developed mass-market, fast-charging EV by Mar'22 and 3) swappable battery solution through the [JV with Gogoro](#) later in CY22. We roll forward to FY24E and cut our FY22/23E EBITDA by 6-8%. We reiterate our BUY rating with a target price of Rs 3,342 (12x FY24E EV/EBITDA). We see value at the CMP as Hero is on course to deliver a 5% FCF yield with 20+% RoE in FY24E. Improvement in domestic 2W demand and quicker-than-expected launches in the EV space can drive re-rating.

Key takeaways from earnings con-call:

- Demand scenario and outlook:** Customer footfalls and enquiries, especially in the northern region, are seeing an uptick. Replacement buying has resumed over the past few months (during the marriage season); it currently forms ~20% of total sales vs. ~30% contribution pre-COVID. The management expects rural demand to recover with the re-opening of the economy, aiding a rebound in 2W sales in FY23E. A new scooter launch in the fast-growing 125cc segment is also in the works to gain scooter market share.
- RM cost headwinds and price hikes:** Given the raw material cost pressures, the company took an average price hike of Rs 1,000 in 2Q and Rs 500 in 3Q. With commodity costs now peaking out, the management expects cost pressures to be much lower in FY23E. The LEAP program should continue to support cost savings (~320bps YoY savings in 3Q).
- Financing:** Retail financing penetration was 58% in 3Q vs. 55% QoQ (40-50% pre-COVID); of this, its in-house financing arm, Hero Fincorp, contributed 35% (broadly stable QoQ/YoY). The management highlighted that financing penetration has been improving across segments. Hero Fincorp raised a capital of ~Rs 20bn (Hero invested ~Rs 1.5bn) during the quarter, aiming to increase its AUM by 2x to ~Rs 500bn over the medium term.
- Inventory levels are currently high at ~7-8 weeks.**
- EV segment plans:** Hero has a three-pronged EV strategy which includes mass-market, in-house products (being developed at its Germany & Jaipur R&D facilities), investment in Ather Energy and tie-up with Gogoro, Taiwan for battery swapping infrastructure ([see our detailed note on EVs](#)). It is on course to launch its first in-house electric scooter by Mar'22 with a fast-charging option and is collaborating with several players in the EV ecosystem. It will import cells and manufacture battery packs in-house at its new Andhra Pradesh facility. Hero plans to leverage the distribution network for its EV product while opening some exclusive stores for its E-2W products.
- Spare parts sales** stood at Rs 11.9bn (+4% QoQ), forming ~15% of sales in 3Q against 13% of sales QoQ. Hero has increased its focus on non-product revenue streams i.e., spare parts, accessories and aftermarket segments.

Outlook and valuation: We estimate volume/revenue/EBITDA/APAT CAGRs of 5%/7%/5%/6% between FY21-23E and see upside risks to our estimates. At the CMP, the stock trades at 17.3x/15.3x PER and 10.7x/9.3x EV/EBITDA on FY23E/24E.

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Exhibit 1: Reported numbers vs. expectations

| Rs mn | Reported | Est | Var % | Consensus | Var % |
|-------------------|----------|--------|-------|-----------|-------|
| Net Sales | 78,833 | 76,658 | 2.8 | 78,307 | 0.7 |
| EBITDA | 9,600 | 9,436 | 1.7 | 9,327 | 2.9 |
| EBITDA Margin (%) | 12.2 | 12.3 | -13 | 11.9 | 27 |
| Adj PAT | 6,861 | 6,992 | (1.9) | 7,340 | 2.9 |
| Adj EPS | 34.4 | 35.0 | (1.9) | 36.8 | (6.5) |

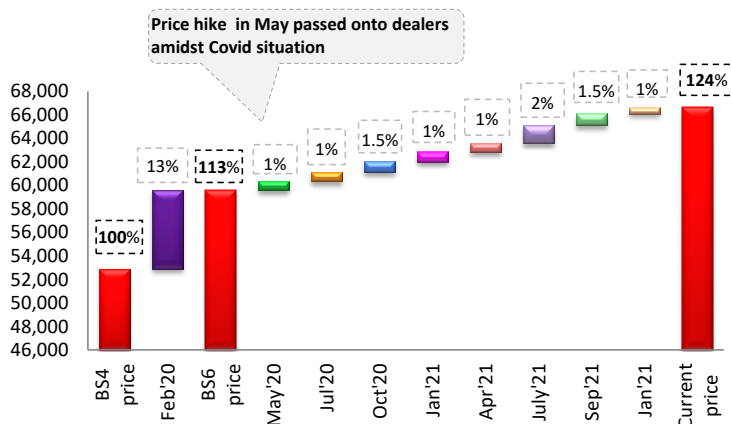
Source: Company, Systematix Institutional Research

Exhibit 2: Quarterly performance

| Standalone (Rs mn) | 3QFY21 | 4QFY21 | 1QFY22 | 2QFY22 | 3QFY22 | YoY (%) | QoQ (%) |
|-----------------------------|------------------|------------------|------------------|------------------|------------------|---------------|---------------|
| Net sales | 97,758 | 86,860 | 54,871 | 84,534 | 78,833 | (19.4) | (6.7) |
| - Raw material | 68,912 | 61,173 | 39,796 | 61,104 | 55,943 | (18.8) | (8.4) |
| (% of net sales) | 70.5 | 70.4 | 72.5 | 72.3 | 71.0 | 47 | -132 |
| - Staff expenditure | 5,167 | 4,884 | 4,357 | 5,054 | 5,180 | 0.3 | 2.5 |
| (% of net sales) | 5.3 | 5.6 | 7.9 | 6.0 | 6.6 | 129 | 59 |
| - Other expenditure | 9,543 | 8,691 | 5,570 | 7,712 | 8,109 | (15.0) | 5.1 |
| (% of net sales) | 9.8 | 10.0 | 10.2 | 9.1 | 10.3 | 53 | 116 |
| Total expenditure | 83,621 | 74,748 | 49,722 | 73,870 | 69,233 | (17.2) | (6.3) |
| EBITDA | 14,136 | 12,112 | 5,148 | 10,664 | 9,600 | (32.1) | (10.0) |
| EBITDA Margin (%) | 14.5 | 13.9 | 9.4 | 12.6 | 12.2 | -228 | -44 |
| Depreciation | 1,698 | 1,631 | 1,630 | 1,639 | 1,644 | (3.2) | 0.3 |
| EBIT | 12,438 | 10,480 | 3,519 | 9,025 | 7,956 | (36.0) | (11.8) |
| Interest | 47 | 63 | 61 | 65 | 65 | 40.0 | (0.5) |
| Other Income | 2,027 | 874 | 1,386 | 1,569 | 1,216 | (40.0) | (22.5) |
| PBT | 14,418 | 11,291 | 4,844 | 10,529 | 9,107 | (36.8) | (13.5) |
| Tax | 3,574 | 2,642 | 1,189 | 2,585 | 2,246 | (37.2) | (13.1) |
| Reported PAT | 10,845 | 8,650 | 3,654 | 7,944 | 6,861 | (36.7) | (13.6) |
| Adjusted PAT | 10,845 | 8,650 | 3,654 | 7,944 | 6,861 | (36.7) | (13.6) |
| Adjusted EPS (Rs) | 54.3 | 43.3 | 18.3 | 39.8 | 34.4 | (36.7) | (13.6) |
| Total volumes (Nos) | 18,45,274 | 15,68,313 | 10,24,489 | 14,39,142 | 12,92,136 | (30.0) | (10.2) |
| Net realisation (Rs) | 52,977 | 55,384 | 53,559 | 58,739 | 61,010 | 15.2 | 3.9 |
| EBITDA / vehicle (Rs) | 7,661 | 7,723 | 5,025 | 7,410 | 7,430 | (3.0) | 0.3 |

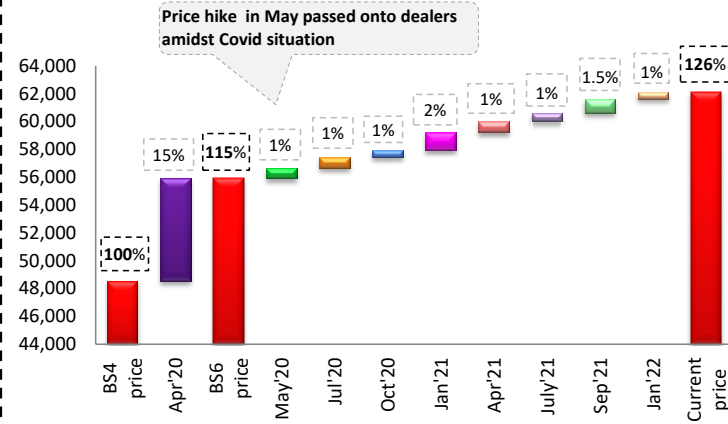
Source: Company, Systematix Institutional Research

Exhibit 3: Price hikes for Hero HF Deluxe



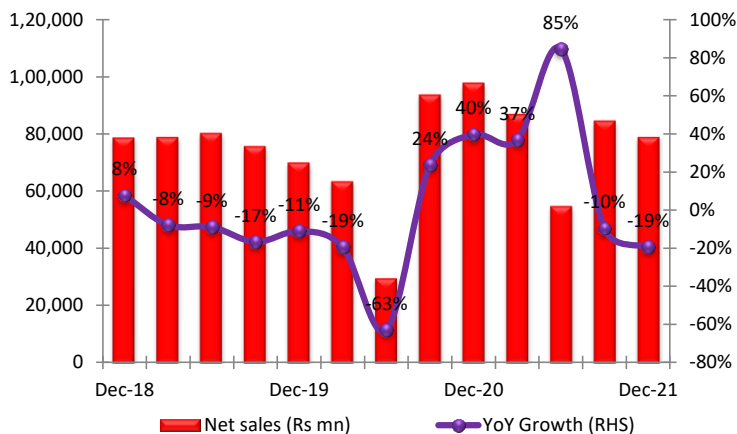
Source: Company, Systematix Institutional Research

Exhibit 4: Price hikes for Hero Splendor



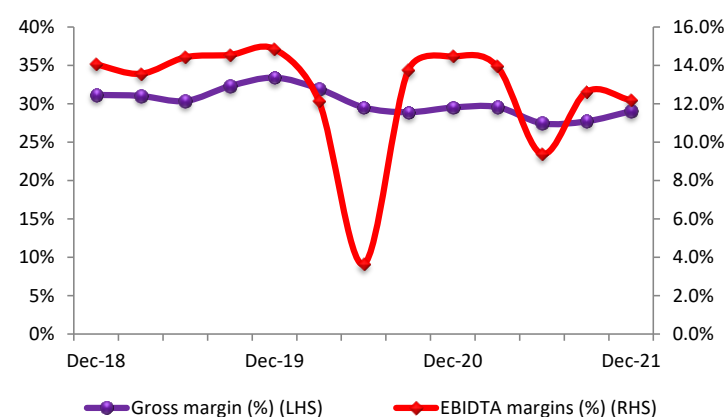
Source: Company, Systematix Institutional Research

Exhibit 5: Revenue and YoY growth trend



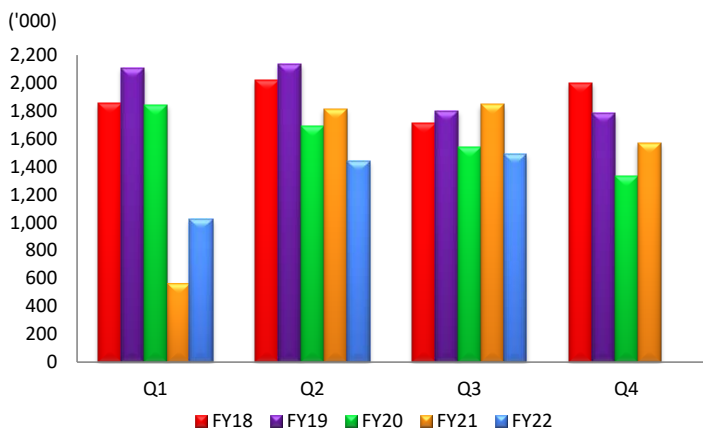
Source: Company, Systematix Institutional Research

Exhibit 6: Gross margin/EBITDA margin trend



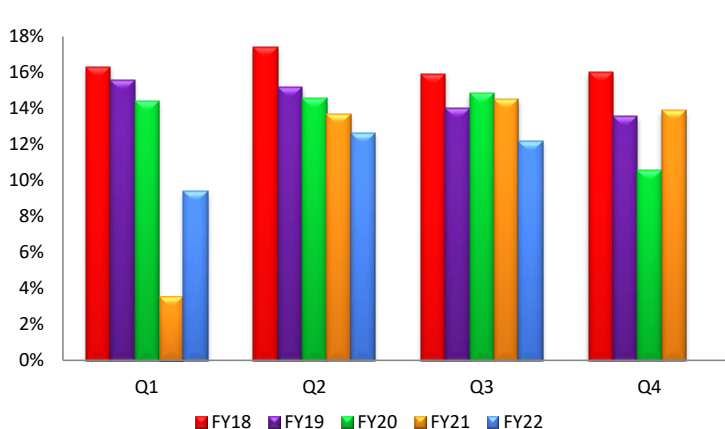
Source: Company, Systematix Institutional Research

Exhibit 7: Quarterly volume trend



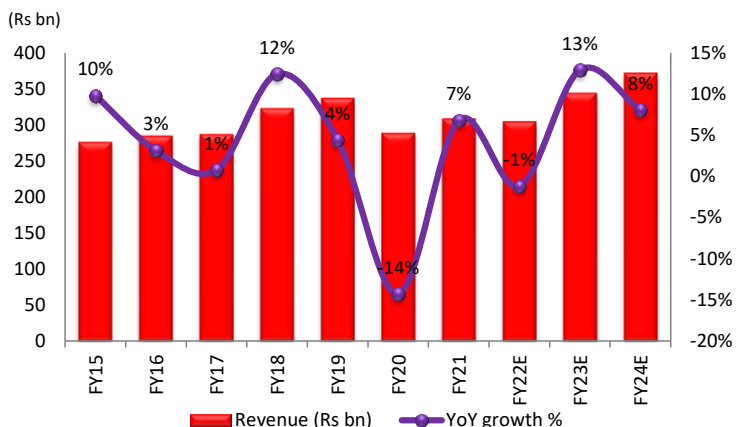
Source: Company, Systematix Institutional Research

Exhibit 8: Quarterly EBITDA margin trend



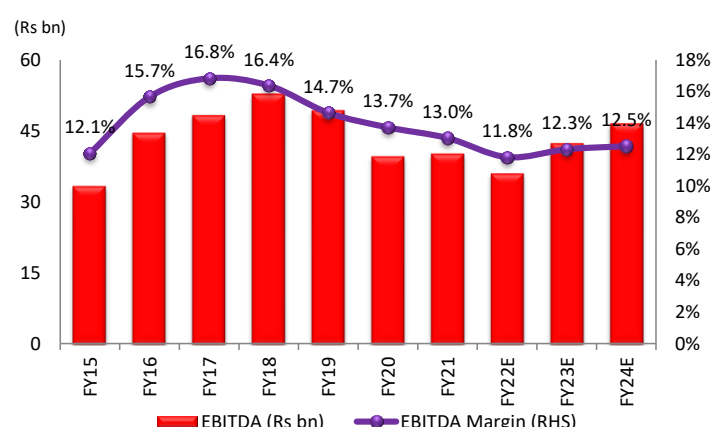
Source: Company, Systematix Institutional Research

Exhibit 9: Annual revenue and YoY growth (RHS)



Source: Company, Systematix Institutional Research

Exhibit 10: Annual EBITDA and EBITDA margins (RHS)



Source: Company, Systematix Institutional Research

Exhibit 11: Annual segment-wise volume trend

| Volume (units) | FY16 | FY17 | FY18 | FY19 | FY20 | FY21 | FY22E | FY23E | FY24E |
|----------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Domestic Motorcycles | 56,03,136 | 56,93,681 | 64,99,051 | 68,93,688 | 58,28,782 | 51,57,415 | 45,38,525 | 50,83,148 | 54,89,800 |
| YoY growth % | -1% | 2% | 14% | 6% | -15% | -12% | -12% | 12% | 8% |
| Domestic scooter (incl EV) | 8,18,777 | 7,89,974 | 8,83,667 | 7,19,087 | 4,02,676 | 4,43,458 | 3,63,636 | 4,54,544 | 5,45,453 |
| YoY growth % | 9% | -4% | 12% | -19% | -44% | 10% | -18% | 25% | 20% |
| Exports | 2,10,239 | 1,80,391 | 2,04,475 | 2,08,056 | 1,78,261 | 1,90,823 | 2,95,048 | 3,30,454 | 3,70,108 |
| YoY growth % | 5% | -14% | 13% | 2% | -14% | 7% | 55% | 12% | 12% |
| Total volume | 66,32,152 | 66,64,046 | 75,87,193 | 78,20,831 | 64,09,719 | 57,91,696 | 51,97,209 | 58,68,146 | 64,05,362 |
| YoY growth % | 0% | 0% | 14% | 3% | -18% | -10% | -10% | 13% | 9% |

Source: SIAM, Company, Systematix Institutional Research

FINANCIALS (STANDALONE)

Profit & Loss Statement

| YE: Mar (Rs mn) | FY20 | FY21 | FY22E | FY23E | FY24E |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Net sales | 2,88,361 | 3,08,006 | 3,04,258 | 3,43,536 | 3,71,236 |
| Growth, % | -14 | 7 | -1 | 13 | 8 |
| RM expenses | -1,96,974 | -2,17,623 | -2,19,066 | -2,43,911 | -2,63,578 |
| Employee expenses | -18,417 | -18,987 | -19,472 | -20,956 | -21,532 |
| Other expenses | -33,390 | -31,203 | -29,711 | -36,296 | -39,599 |
| EBITDA | 39,580 | 40,192 | 36,009 | 42,374 | 46,528 |
| Growth, % | -20 | 2 | -10 | 18 | 10 |
| Margin, % | 13.7 | 13.0 | 11.8 | 12.3 | 12.5 |
| Depreciation | -8,180 | -6,769 | -6,524 | -6,911 | -7,341 |
| EBIT | 31,400 | 33,424 | 29,485 | 35,463 | 39,187 |
| Growth, % | -27 | 6 | -12 | 20 | 11 |
| Margin, % | 10.9 | 10.9 | 9.7 | 10.3 | 10.6 |
| Interest paid | -220 | -218 | -218 | -218 | -218 |
| Other Income | 7,783 | 5,799 | 6,378 | 7,144 | 8,001 |
| Non-recurring Items | 6,774 | 0 | 0 | 0 | 0 |
| Pre-tax profit | 38,963 | 39,004 | 35,645 | 42,388 | 46,970 |
| Tax provided | -9,404 | -9,362 | -8,556 | -10,174 | -11,274 |
| Profit after tax | 29,559 | 29,642 | 27,089 | 32,214 | 35,696 |
| Others (Minorities, Associates) | - | - | - | - | - |
| Net Profit | 36,333 | 29,642 | 27,089 | 32,214 | 35,696 |
| Growth, % | 7 | -18 | -9 | 19 | 11 |
| Net Profit (adjusted) | 29,559 | 29,642 | 27,089 | 32,214 | 35,696 |

Source: Company, Systematix Institutional Research;

Balance Sheet

| YE: Mar (Rs mn) | FY20 | FY21 | FY22E | FY23E | FY24E |
|---------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Cash & bank | 2,419 | 2,572 | -5,186 | -4,783 | -3,396 |
| Marketable securities cost | 72,141 | 91,230 | 99,251 | 1,07,877 | 1,17,131 |
| Debtors | 16,031 | 24,268 | 16,672 | 18,824 | 20,342 |
| Inventory | 10,920 | 14,696 | 8,336 | 9,412 | 10,171 |
| Loans & advances | 896 | 892 | 898 | 999 | 1,080 |
| Other current assets | 10,417 | 9,938 | 10,931 | 12,024 | 13,227 |
| Total current assets | 40,683 | 52,364 | 31,651 | 36,476 | 41,423 |
| Investments | 10,086 | 13,767 | 16,245 | 19,169 | 22,619 |
| Gross fixed assets | 1,42,244 | 1,47,726 | 1,55,726 | 1,65,726 | 1,75,726 |
| Less: Depreciation | -81,073 | -87,841 | -94,366 | -1,01,277 | -1,08,618 |
| Add: Capital WIP | 3,413 | 4,366 | 4,366 | 4,366 | 4,366 |
| Net fixed assets | 61,171 | 59,884 | 61,360 | 64,449 | 67,108 |
| Total assets | 1,87,493 | 2,21,611 | 2,12,873 | 2,32,337 | 2,52,647 |
| Current liabilities | 39,512 | 62,257 | 47,243 | 52,450 | 56,919 |
| Provisions | 2,689 | 3,328 | 498 | 2,521 | 2,647 |
| Total current liabilities | 42,201 | 65,585 | 47,740 | 54,971 | 59,565 |
| Non-current liabilities | 3,928 | 4,041 | 4,041 | 4,041 | 4,041 |
| Total liabilities | 46,129 | 69,626 | 51,781 | 59,012 | 63,606 |
| Paid-up capital | 400 | 400 | 400 | 400 | 400 |
| Reserves & surplus | 1,40,965 | 1,51,585 | 1,60,692 | 1,72,926 | 1,88,642 |
| Shareholders' equity | 1,41,364 | 1,51,984 | 1,61,092 | 1,73,325 | 1,89,041 |
| Total equity & liabilities | 1,87,493 | 2,21,611 | 2,12,873 | 2,32,337 | 2,52,647 |

Source: Company, Systematix Institutional Research

Cash Flow

| YE: Mar (Rs mn) | FY20 | FY21 | FY22E | FY23E | FY24E |
|------------------------------|----------------|----------------|----------------|----------------|----------------|
| Pre-tax profit | 45,737 | 39,004 | 35,645 | 42,388 | 46,970 |
| Depreciation | 8,180 | 6,769 | 6,524 | 6,911 | 7,341 |
| Chg in working capital | 25,222 | 11,857 | -4,889 | 2,807 | 1,035 |
| Total tax paid | -10,841 | -9,249 | -8,556 | -10,174 | -11,274 |
| CFO | 54,101 | 41,727 | 22,565 | 35,007 | 36,289 |
| Capital expenditure | -13,586 | -5,146 | -8,000 | -10,000 | -10,000 |
| Chg in investments | -556 | -555 | -555 | -555 | -555 |
| Chg in marketable securities | -21,984 | -22,215 | -9,945 | -10,994 | -12,149 |
| CFI | -28,831 | -22,099 | -12,121 | -14,406 | -14,704 |
| Free cash flow | 39,959 | 36,026 | 14,009 | 24,452 | 25,734 |
| Debt raised/(repaid) | 0 | 0 | 0 | 0 | 0 |
| Dividend (incl. tax) | -23,991 | -19,257 | -17,982 | -19,980 | -19,980 |
| CFF | -24,211 | -19,475 | -18,200 | -20,198 | -20,198 |
| Net chg in cash | 1,059 | 153 | -7,757 | 402 | 1,387 |
| Opening cash balance | 1,360 | 2,419 | 2,572 | -5,186 | -4,783 |
| Closing cash balance | 2,419 | 2,572 | -5,186 | -4,783 | -3,396 |

Source: Company, Systematix Institutional Research

Ratios

| YE: Mar | FY20 | FY21 | FY22E | FY23E | FY24E |
|--------------------------|-------|-------|-------|-------|-------|
| EPS (INR) | 148 | 148 | 136 | 161 | 179 |
| PER (x) | 18.4 | 18.4 | 20.1 | 16.9 | 15.2 |
| Price/Book (x) | 3.8 | 3.6 | 3.4 | 3.1 | 2.9 |
| EV/EBITDA (x) | 11.9 | 11.2 | 12.5 | 10.4 | 9.3 |
| EV/Net sales (x) | 1.6 | 1.5 | 1.5 | 1.3 | 1.2 |
| RoE (%) | 22 | 20 | 17 | 19 | 20 |
| RoCE (%) | 28 | 26 | 22 | 25 | 25 |
| Fixed Asset turnover (x) | 2.0 | 2.1 | 2.0 | 2.1 | 2.1 |
| Dividend Yield (%) | 3.3 | 3.9 | 3.3 | 3.7 | 3.7 |
| Receivable (days) | 20 | 29 | 20 | 20 | 20 |
| Inventory (days) | 16 | 20 | 11 | 11 | 11 |
| Payable (days) | 44 | 71 | 49 | 49 | 49 |
| Revenue Growth (%) | -14 | 7 | -1 | 13 | 8 |
| EBITDA Growth (%) | -20 | 2 | -10 | 18 | 10 |
| EPS Growth, % | -13 | 0 | -9 | 19 | 11 |
| Net D/E ratio (x) | (0.6) | (0.6) | (0.6) | (0.6) | (0.6) |

Source: Company, Systematix Institutional Research

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| | | | |
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| | | | |
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DISCLOSURES/APPENDIX

I. ANALYST CERTIFICATION

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