

HERO MOTOCORP LIMITED

Strong margin performance, Maintain BUY

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Hero Motocorp Ltd (Hero) reported strong set of numbers in Q2 FY24. Volumes de-grew by 0.8% yoy and 4.7% qoq as 2W segment saw a gradual sequential pick-up in growth post a dull FY 23. Topline grew by 4.1% yoy on 7.7% qoq on growth in ASPs and better product mix. Net realizations grew by 2.9% qoq and 4.9% yoy to Rs66.7K. The spares business also supported the cause as they had a good growth. The retail demand in Q2 witnessed a solid growth on the back of array of XTech launches (30% of volumes currently), pick up in rural demand and various variants launches of existing models. Input costs to sales ratio in Q2 was at 68.6%, down from 69.4% qoq and 72% yoy as commodity costs softened. Other expenses to sales moved up to 11.2% from 10.6% yoy on higher EV expenses, expansion in dealerships, new launches etc. EBITDA margins were sequentially up by 30 bps and 270 bps at 14.13% supported by the input cost benefits, LEAP-2 benefits, operating leverage and product mix tilted towards high margin premium products. As depreciation expenses remained flattish yoy and qoq, and other income grew handsomely, PBT grew by 45% yoy while PAT grew by 47% yoy at Rs10.53 bn.

Volume growth to be seen on launches, festive cheer and rural pick-up

The company is gaining strength through the XTech (Extra Technology) variant expansion across its brands (30% of current demand) seen in Q2. In the premium bikes segment, the company attained market share of higher single digits on the back of the launches of X-treme 160R and X-Pulse 200T bikes. Going forward, the intrinsic growth drivers are expected to remain intact with the rural markets showing good growth in the key markets of North, Central and East through Hero's mass segment bike HF Deluxe showing a double digit growth. Rabi crop season seems to be bullish although the south west monsoon was low and patchy. Demand for Hero's 125 cc bikes like the Super Splendor XTech, Passion and its variants and Glamour led bulk of demand in the quarter. Urban demand remained strong throughout the quarter. The company plans to launch 5-6 premium bikes by Q4 FY24.

On the EV side, Hero has forged several partnerships and collaborations on this front including charging infrastructure. The company has plans to expand its EV presence upto 100 cities by end of FY24 and is well on track currently. Increased emphasis on premiumization by launching high end variants under the X-Tech brand, Harley Davidson and Karizma launches in the premium segment should enable the company to post a good volume growth in FY 24E and FY 25E and increase its market share further.

Key Financials	FY 22	FY 23	FY 24E	FY 25E
Revenues (Rs bn)	292	338	376	435
EBITDA (%)	11.5	11.8	13.9	14.7
PAT (%)	8.5	8.6	11.1	11.7
EPS (Rs)	123.8	145.7	208.3	255.6
EPS growth (%)	-16.6%	17.7%	42.9%	22.7%
P/E (x)	24.7	20.9	14.7	11.9
P/B (x)	1.8	1.7	1.6	1.5
EV/EBITDA (x)	15.7	13.5	10.0	8.2
ROCE (%)	14.9%	17.3%	22.4%	25.3%
ROE (%)	15.7%	17.4%	23.2%	26.2%
Dividend yield (%)	3.1%	3.3%	4.8%	5.9%

Rating	BUY
Current Market Price (₹)	3,060
12 M Price Target (₹)	3,579
Potential upside (%)	17

Stock Data

Sector :	Two-Wheelers
FV (₹) :	2
Total Market Cap (₹ bn) :	612
Free Float Market Cap (₹ bn) :	398
52-Week High / Low (₹) :	3,275 / 2,246
12M Avg. Dly Traded Volume (in lakh)	6
BSE Code / NSE Symbol	50018 / HEROMOTOCO
Bloomberg :	HMCL IN

Shareholding Pattern

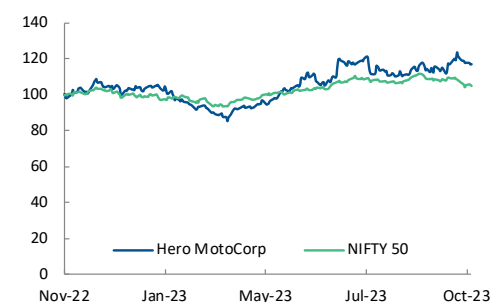
(%)	Sep-23	Jun-23	Mar-23	Dec-22
Promoter	34.77	34.77	34.77	34.77
FPIs	26.80	28.10	27.00	27.47
MFs	12.49	10.33	12.15	11.07
Insurance	13.79	13.86	13.08	13.37
Others	12.15	12.94	13.00	13.32

Source: BSE

Price Performance

(%)	1M	3M	6M	12M
Hero Motocorp	1.2%	-0.3%	20.9%	17.0%
Nifty 50	-3.3%	-3.8%	5.1%	5.0%

* To date / current date : November 2, 2023

Hero Motocorp vs Nifty 50

Management has emphasized that FY 24 shall be the year when Hero shall launch highest number of bikes ever in their history. In the scooters segment, the newly launched 110 cc Zoom has gained solid response is expected further to gain Hero's market share beyond current 10%, which has grown from 6% yoy as schools and colleges have reopened. In the 125 cc segment there is a transition going on as Destini is taking over from Maestro Edge which is getting phased out. The first 17 days of festive season has been very robust, during which the management expects retails to grow at 15% yoy.

Margins may show growth as EV expenses may get offset by operating leverage tailwinds and cost savings

Hero's EBITDA margins in Q2 came 270 bps higher at 14.1% yoy as we saw the lag effect of main input costs like those of steel and aluminium declining. There were other cost savings under LEAP-2 program as well. The company took reasonable price hikes in the quarter. Along with this, the favorable product mix and higher operating leverage has led the company to achieve its margin target of early of 14-16% in the medium to long term. Premiumization of bikes with the help of global partner Harley Davidson shall augur well further for a rich product mix. The launches of XTech variants which are priced higher by 5-7% than the conventional models should help the margins further to grow as operating leverage comes into play. We however believe that as volumes increase on the EV side (currently selling 2K units per month), operating leverage and cost saving programs should offset the 100 bps impact(guided by the management on account of EV proliferation) on margin performance going ahead.

Quarterly Financial Snapshot

YE Mar (₹ mn)	Q2 FY24	Q1 FY24	% QoQ	Q2 FY23	% YoY
Total Net Sales	94,454	87,672	7.7%	90,754	4.1%
RM cost	64,780	60,809	6.5%	65,301	-0.8%
Employee cost	5,768	5,802	-0.6%	5,490	5.1%
Other expenses	10,624	9,000	18.0%	9,579	10.9%
EBITDA	13,283	12,062	10.1%	10,383	27.9%
<i>EBITDA margins (%)</i>	14.1	13.8	30 bps	11.4	270 bps
Other income	2,483	2,222	11.8%	921	169.7%
Depreciation	1,749	1,690	3.5%	1,634	7.0%
Interest	47.6	46.6	100 bps	33.1	43.8%
PBT	13,970	12,547	11.3%	9,637	45.0%
Tax	3,431	2,701	27.1%	2,476	38.6%
PAT	10,538	9,846	7.0%	7,161	47.2%
<i>PAT margins (%)</i>	11.2	11.2	100 bps	7.9	320 bps
Exceptional items	-	-	N/A	-	N/A
Adjusted PAT	10,538	9,846	7.0%	7,161	47.2%
<i>APAT margins (%)</i>	11.2	11.2	0 bps	7.9	320 bps

Source: Company, LKP Research

Outlook and Valuation

Hero posted healthy set of numbers in Q2, led by pick up in volume performance, supported by sound ASP growth. Margins grew well as the input cost benefits, cost savings, operating leverage and product mix helped the cause. Going forward, we expect decent volume trajectory with the XTech variants launched last year, new launches coming up in the 125 cc segment, scooters Zoom & Destini and premium bike launches under the Hero as well as the HD brand. Expansion of the EV scooter in more cities soon will further add to the steam. Demand levers in the rural markets are positive, despite low monsoons on account of a strong El Nino. Festive season has started on a strong wicket and is expected to continue in similar fashion. Hero's high stake (37.5%) in Aether Energy to manufacture Electric Scooters and battery swapping platform shall give Hero a good fillip in the EV 2W space. Profitability would improve through better product mix on Hero's premiumization theme under which the focus of the company is now on the premium bikes and X-Tech variants, price hikes, cost saving programs like LEAP-2 and operating leverage stemming from improving volumes. EV spending may impact margins in the initial period till we see an expansion of scale and volumes. We therefore maintain our BUY rating on the stock with FY 25E target price of Rs 3,579 (valued at 14x v/s current multiple of 12x). Improving return ratios, zero debt and dividend yield of 3.3% in FY 23 gives investors an additional comfort.

All figs in ₹	Q2 FY24	Q1 FY24	Q4 FY23	Q3 FY23	Q2 FY23	Q1 FY23	Q4 FY22	Q3 FY22
Volumes (mn)	1.42	1.35	1.27	1.24	1.43	1.39	1.19	1.29
Net Realization	66,680	64,819	65,382	64,782	63,545	60,370	62,417	61,018
Material Cost/Unit	45,731	44,958	44,442	44,965	45,724	43,932	43,248	43,301
Staff Cost/Unit	4,072	4,289	4,385	4,401	3,844	3,871	4,006	4,009
Other Expn/Unit	7,500	6,654	8,032	7,961	6,707	5,799	8,203	6,277
Total Expn/Unit	57,303	55,901	56,858	57,327	56,275	53,602	55,457	53,587
EBITDA/unit	9,377	8,918	8,524	7,455	7,270	6,767	6,960	7,431
Net profit /unit	7,439	7,280	6,761	5,736	5,014	4,492	5,274	5,311

Source: Company, LKP Research

Income Statement

(₹ mn)	FY 22	FY 23	FY 24E	FY 25E
Total Revenues	292,455	338,056	376,256	434,727
Raw Material Cost	208,267	238,581	260,369	299,961
Employee Cost	19,354	21,898	23,704	26,084
Other Exp	31,145	37,715	39,883	44,777
EBITDA	33,688	39,862	52,300	63,905
EBITDA Margin(%)	11.5	11.8	13.9	14.7
Other income	5569	5652	8800	10000
Depreciation	6,498	6,570	6,871	7,393
Interest	258	199	200	220
PBT	32,501	38,745	54,029	66,292
PBT Margin(%)	11.1	11.5	14.4	15.2
Exceptional items	0	0	0	0
Tax	7,771	9,640	12,427	15,247
PAT	24,730	29,105	41,602	51,045
PAT Margins (%)	8.5	8.6	11.1	11.7
Adj PAT	24,730	29,105	41,602	51,045
Adj PAT Margin (%)	8.5	8.6	11.1	11.7

Key Ratios

YE Mar	FY 22	FY 23	FY 24E	FY 25E
Per Share Data (Rs)				
Adj. EPS	123.8	145.7	208.3	255.6
CEPS	156.4	178.6	242.7	292.6
BVPS	790.1	836.3	898.8	975.4
DPS	95.0	100.0	145.8	178.9
Growth Ratios(%)				
Total revenues	-5.0%	15.6%	11.3%	15.5%
EBITDA	-16.2%	18.3%	31.2%	22.2%
PAT	-16.6%	17.7%	42.9%	22.7%
EPS Growth	-16.6%	17.7%	42.9%	22.7%
Valuation Ratios (x)				
PE	24.7	20.9	14.7	11.9
P/CEPS	19.5	17.1	12.6	10.4
P/BV	1.8	1.7	1.6	1.5
EV/Sales	2.1	1.8	1.6	1.4
EV/EBITDA	15.7	13.5	10.0	8.2
Operating Ratios (Days)				
Inventory days	19.7	21.9	23.0	25.0
Receivable Days	28.8	30.2	29.0	28.0
Payables day	52.9	50.8	51.0	52.0
Net Debt/Equity (x)	0.04	0.04	0.02	(0.00)
Profitability Ratios (%)				
ROCE	14.9%	17.3%	22.4%	25.3%
ROE	15.7%	17.4%	23.2%	26.2%
Dividend yield	3.1%	3.3%	4.8%	5.9%

Balance Sheet

(₹ mn)	FY 22	FY 23	FY 24E	FY 25E
EQUITY & LIABILITIES				
Equity Share Capital	400	400	400	400
Reserves & Surplus	157,430	166,651	179,132	194,445
Total Networth	157,829	167,051	179,531	194,845
Total debt	0	0	0	0
Deferred Tax Liability	6,807	7,360	7,360	7,360
Long term provisions	1,781	1,981	1,981	1,981
Total non current liabilities	8,587	9,341	9,341	9,341
Current Liab & Prov				
Current liabilities	42,348	47,033	52,573	61,934
Other liabilities & Provisions	8,378	9,209	9,209	9,209
Total Equity and Liabilities	217,140	232,631	250,652	275,326
ASSETS				
Net block	50,943	48,682	49,811	51,419
Capital WIP	5,009	5,216	6,716	9,216
Intangible assets	6,694	8,354	8,354	8,354
Deferred tax assets	0	0	0	0
Long term investments	48,147	73,725	75,725	77,725
Long term loans & advances	3,825	4,574	4,574	4,574
Other non current assets	1,372	1,713	1,713	1,713
Total non-current assets	115,990	142,264	146,893	153,000
Current Assets				
Current investments	58,377	36,379	44,379	52,379
Cash and Bank	1,751	3,455	5,581	9,486
Inventories	11,227	14,341	15,693	18,902
Sundry Debtors	23,043	27,982	29,894	33,349
Loan, Advances & others	6,753	8,211	8,211	8,211
Other current assets	229	237	237	237
Total Assets	217,140	232,631	250,652	275,326

Cash Flow

(₹ mn)	FY 22	FY 23	FY 24E	FY 25E
PAT	24,730	29,106	41,602	51,045
Depreciation	6,498	6,570	6,871	7,393
Interest	780	199	200	220
Income Tax paid	(7,688)	(8,496)	(12,427)	(15,247)
Chng in working capital	(6,825)	(5,832)	2,275	2,698
Cash flow from operations (a)	20,204	25,791	50,948	61,356
Capital expenditure	(5,347)	(5,777)	(9,500)	(11,500)
Chng in investments	3,320	8,150	(10,000)	(10,000)
Other investing activities	508	(7,061)	1,771	0
Cash flow from investing (b)	(1,519)	(4,688)	(17,729)	(21,500)
Free cash flow (a+b)	18,685	21,103	33,219	39,856
Inc/dec in borrowings	0	0	0	0
Dividend paid (incl. tax)	(18,981)	(19,983)	(29,122)	(35,731)
Other financing activities	(208)	(166)	(200)	(220)
Cash flow from financing (c)	(19,389)	(20,406)	(29,322)	(35,951)
Net chng in cash (a+b+c)	(704)	697	3,897	3,904
Closing cash & cash equivalents	987	1,684	5,581	9,486

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