

Prioritize premiumization

CMP: INR 3,052

Rating: Buy

Target Price: INR 3,896

Stock Info

| | |
|--------------------------|-------------------|
| BSE | 500182 |
| NSE | HEROMOTCO |
| Bloomberg | HMCL IN |
| Reuters | HROM.BO |
| Sector | Auto-2&3 wheelers |
| Face Value (INR) | 2 |
| Equity Capital (INR mn) | 399.6 |
| Mkt Cap (INR mn) | 608,601 |
| 52w H/L (INR) | 3275/2246 |
| Avg Yearly Vol (in 000') | 552 |

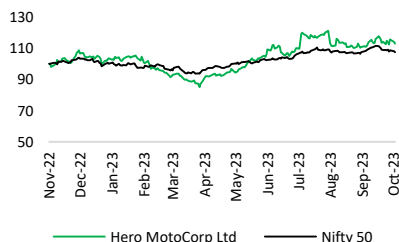
Shareholding Pattern %

(As on Sep, 2023)

| | |
|-----------|-------|
| Promoters | 34.77 |
| FII | 26.80 |
| DII | 15.21 |
| Public | 23.22 |

| Stock Performance (%) | 1m | 3m | 12m |
|-----------------------|------|------|------|
| Hero MotoCorp | -0.3 | 1.7 | 15.2 |
| Nifty | -2.5 | -2.0 | 5.8 |

Hero MotoCorp Vs Nifty



HeroMotoCorp reported a good performance beat on all fronts: Standalone revenue stood at INR 94,454 Mn, against our estimate of INR 92505 Mn registering a growth of 4.0% YoY. EBITDA stood at INR 13,283 Mn, against our estimate of INR 12,690 Mn, Registering a growth of 28%YoY. On the margins front, EBITDA margin expansion by 260bps YoY to 14.1%, against our estimate of 12.9% led by softening in RM price, leap savings, and product mix. Standalone PAT saw a growth of 47%YoY to INR 10,538 Mn against our estimate of INR 9,356 Mn. EPS stood at INR 52.7 in Q2FY24 against INR 41.2in Q1FY24 (INR 35.8 in Q2FY23). The company strengthened its premium portfolio with the launch of the co-developed Harley-Davidson X440, introduced the iconic Karizma as Karizma XMR, and expanded the premium lineup with the Xtreme 200S 4V. The Harley-Davidson X440 received over 25,000 bookings.

HMCL's Strategic Product Revamp and Market Insights: HMCL is revamping its product portfolio to fill gaps. Glamour 125cc is gaining market share, and the Harley X440 collaboration received 27k bookings. Hero Xoom and Destini Prime will boost scooter sales. Despite high channel inventory, HMCL plans to reduce it to 4-6 weeks post-festive season. Strong post-festive season demand is expected, driven by the upcoming marriage season.

Margin Expansion and Market Adaptation Strategies at HMCL: We expect improved margins in the next quarter due to lower metal prices, a focus on premium products, and increased sales volume. HMCL has adapted to changing market trends with a strong demand for premium products like Passion, Glamour, and XTEC variants. This is likely to boost market share and further enhance product mix and ASPs, positively impacting margins.

Outlook and valuation

HMCL reported a good set of performance during Q2FY24 led by better product mix and accelerated savings programs, and a strong demand environment. Festive season sales are up by 15% compared to the previous year, and we anticipate continued strong performance. Rural demand is increasing, especially in the entry-level segment with HF Deluxe and Passion showing substantial growth. Bookings for recently launched models, Harley Davidson (HD) - X440 and Karizma XMR, are strong. **We maintain our Buy rating on the stock and value it SOTP valuation for a revised target price of INR 3,896 per share (earlier target price; INR 3,699 per share).**

Exhibit 1: Financial Performance

| YE March (INR Mn) | Net Sales | EBITDA | PAT | EPS (INR) | EBITDA Margin % | RoE (%) | P/E (x) |
|-------------------|-----------|--------|--------|-----------|-----------------|---------|---------|
| FY23 | 338,057 | 39,861 | 29,105 | 145.6 | 11.79 | 17.9 | 21.0 |
| FY24E | 370,667 | 52,217 | 40,175 | 201.0 | 14.09 | 22.8 | 15.2 |
| FY25E | 410,209 | 58,243 | 44,155 | 220.9 | 14.20 | 22.5 | 13.8 |
| FY26E | 448,267 | 64,156 | 48,822 | 244.3 | 14.31 | 30.0 | 12.5 |

Source: Arihant Research, Company Filings

Abhishek Jain
abhishek.jain@arihantcapital.com
022 67114851

Jyoti Singh
jyoti.singh@arihantcapital.com
022 67114834

Q2FY24 Conference call highlights

Double digit growth in the first 17 days of festival

Premium Stores Expansion:

The store expansion is progressing rapidly; recently launched first premium HeroMoto store and plan to reach 100-plus stores within the next six months. In addition, the transformation of existing stores has been swift, with Hero 2.0 stores growing from 20 in March to over 200 in just seven months, with a goal of reaching 500 in the next six months. This expansion isn't limited to physical structures alone; The company is enhancing the digital customer experience, with a comprehensive revamp of product website, customer journey, and OneApp to provide a holistic premium customer experience.

Product Strategy:

The company's product strategy is on track, effectively managing margins. There are plans to introduce additional premium models in the coming months, and price adjustments are in line with industry standards.

Q2 Performance:

Q2 was strategically prepared for the festive season, with promising results, especially in the entry-level segment. Rural demand has seen a significant uptick in the first 17 days, and the Glamour Classic product has been well received.

Regional Growth:

The company's growth is widespread, with Rajasthan leading in the south and consumer demand indicating strong sales. The portfolio is well-prepared for double-digit growth.

Product Focus:

The focus includes 100cc and entry segments, with significant growth potential. The emphasis on personal mobility remains a priority, with plans to strengthen the 150-160cc and further reinforce the 125cc and premium segments.

Ather

Investments in Ather, production ramp-up, and expansion of production capacity are also significant.

Inventory

With a vast network of 6,000 touch points, they possess the capability to efficiently meet demand, resulting in a four to six-week inventory replenishment at the festival's conclusion.

Profitability Outlook:

The profitability outlook is positive, with margin improvements expected in the Passion model, and increased volume anticipated in H2FY24. While DSO increased during the festive season, November's marriage season is expected to boost volume. Gross margin increased by 1.5% following price adjustments.

Other Expenses and Launches:

Other expenses have been on the higher side due to new launches. The launch of Harley Davidson's Karizma XMR has been significant.

EV and Export Markets:

The company sees potential in the growing EV market, and differentiated products are in the pipeline. Export markets like Bangladesh, Colombia, Nigeria, Mexico, and Nepal are performing well, with the company focusing on medium to long-term growth. Both urban and rural segments are participating in business.

Retail Growth:

Retail volume during the last festive season reached 1.2 million, and the industry is expected to grow at double-digit rates. The scooter segment is actively working to retain market share, with the 110cc category gaining ground and the 125cc category undergoing transition with new offerings.

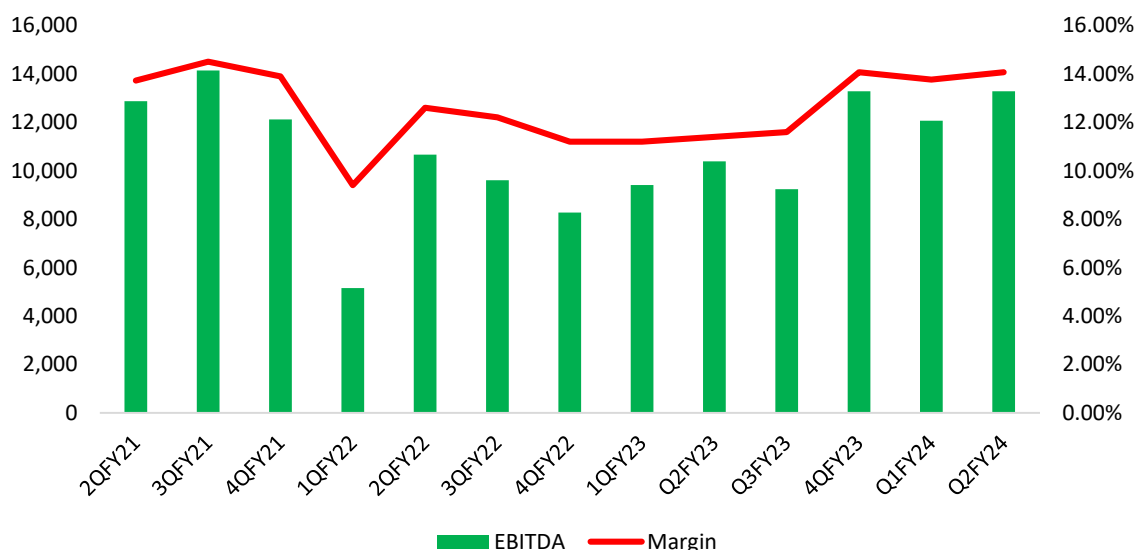
DSO increased during the festive session so not concerning.

Exhibit 2: Quarterly result summary Q2FY24

| Standalone (INR mn) | Q2FY24 | Q1FY24 | 2QFY23 | YoY (%) | QoQ (%) |
|----------------------------|------------------|------------------|------------------|---------------|--------------|
| Net sales | 94,454 | 87,673 | 90,754 | 4.1 | 7.7 |
| - Raw material | 64,780 | 60,809 | 65,301 | (0.8) | 6.5 |
| (% of net sales) | 68.6 | 69.4 | 72.0 | -71bps | -78bps |
| Gross Profit | 29674.5 | 26863.6 | 25452.1 | 16.6 | 10.5 |
| (% of net sales) | 31.4% | 30.6% | 28.0% | 1bps | 1bps |
| - Staff expenditure | 5,768 | 5,802 | 5,490 | 5.1 | (0.6) |
| (% of net sales) | 6.1 | 6.6 | 6.0 | -31bps | -51bps |
| - Other expenditure | 10,624 | 9,000 | 9,579 | 10.9 | 18.0 |
| (% of net sales) | 11.2 | 10.3 | 10.6 | -189bps | 98bps |
| Total expenditure | 81,171 | 75,610 | 80,371 | 1.0 | 7.4 |
| EBITDA | 13,283 | 12,063 | 10,383 | 27.9 | 10.1 |
| EBITDA Margin (%) | 14.1 | 13.8 | 11.4 | 291bps | 30bps |
| Depreciation | 1,749 | 1,690 | 1,634 | 7.0 | 3.5 |
| EBIT | 11,534 | 10,373 | 8,749 | 31.8 | 11.2 |
| Interest | 48 | 47 | 33 | 43.8 | 2.1 |
| Other Income | 2,483 | 2,222 | 921 | 169.7 | 11.8 |
| PBT | 13,970 | 12,548 | 9,637 | 45.0 | 11.3 |
| Tax | 3,431 | 2,701 | 2,476 | 38.6 | 27.1 |
| Reported PAT | 10,538 | 9,847 | 7,161 | 47.2 | 7.0 |
| Adjusted PAT | 8,938 | 8,247 | 7,161 | 24.8 | 8.4 |
| Adjusted EPS (INR) | 52.72 | 41.27 | 35.8 | 47.1 | 27.7 |
| Total volumes (Nos) | 1,416,526 | 1,352,574 | 1,151,012 | 23.1 | 4.7 |
| Net realisation (INR) | 66,680 | 64,819 | 78,847 | (15.4) | 2.9 |
| EBITDA / vehicle (INR) | 9,377 | 8,918 | 9,021 | 4.0 | 5.1 |

Source: Arianth Research, Company Filings

Exhibit 3: Margin expansion led by better product mix



Source: Arianth Research, Company Filings

Exhibit 4:SOTP valuation

| SOTP Valuation | Amount (INR) |
|----------------------------------------------------------------|--------------|
| FY26E Core EPS (INR/share, A) | 244 |
| P/E Multiple assigned (x, B) | 14 |
| Value of Base Business (C=A*B) | 3,420 |
| Ather Energy (P/sales 4x) Per share Value (D) (stake 36.54%) | 114 |
| Hero Fincorp (P/sales 1.5x) Per share Value (E) (stake 41.19%) | 363 |
| D+E=F | 476 |
| Target Price (F+C) | 3,896 |
| CMP INR | 3,052 |
| Potential Upside (%) | 27.7% |

Financial Performance

Profit & Loss Statement

| YE: Mar (INR mn) | FY22 | FY23 | FY24E | FY25E | FY26E |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|
| Net sales | 292,455 | 338,057 | 370,667 | 410,209 | 448,267 |
| Growth, % | (5) | 15.6 | 10 | 11 | 9 |
| RM expenses | -208,267 | -238,581 | -256,872 | -283,865 | -309,753 |
| Employee expenses | -19,354 | -21,898 | -22,240 | -24,613 | -26,896 |
| Other expenses | -31,145 | -37,716 | -39,338 | -43,489 | -47,462 |
| EBITDA | 33,688 | 39,861 | 52,217 | 58,243 | 64,156 |
| Growth, % | (16) | 18 | 31 | 12 | 10 |
| Margin, % | 11.5 | 11.8 | 14.1 | 14.2 | 14.3 |
| Depreciation | -6,498 | -6,570 | -7,630 | -8,080 | -8,530 |
| EBIT | 27,190 | 33,292 | 44,587 | 50,163 | 55,626 |
| Growth, % | (19) | 22 | 34 | 13 | 11 |
| Margin, % | 9.3 | 9.8 | 12.0 | 12.2 | 12.4 |
| Interest paid | -258 | -199 | -203 | -207 | -207 |
| Other Income | 5,569 | 5,652 | 8,477 | 8,647 | 8,820 |
| Pre-tax profit | 32,501 | 38,745 | 52,862 | 58,603 | 64,239 |
| Tax provided | -7,771 | -9,640 | -12,687 | -14,449 | -15,417 |
| Profit after tax | 24,730 | 29,105 | 40,175 | 44,155 | 48,822 |
| Others (Minorities, Associates) | - | - | - | - | - |
| Net Profit | 24,730 | 29,105 | 40,175 | 44,155 | 48,822 |
| Growth, % | (17) | 18 | 38 | 10 | 11 |
| Net Profit (adjusted) | 24,730 | 29,105 | 40,175 | 44,155 | 48,822 |

Balance Sheet

| YE: Mar (INR mn) | FY22 | FY23 | FY24E | FY25E | FY26E |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Cash & bank | 1,751 | 3,455 | 5,883 | 30,290 | 54,822 |
| Marketable securities cost | 94,320 | 96,680 | 95,337 | 93,861 | 92,236 |
| Debtors | 23,043 | 27,982 | 31,481 | 32,592 | 35,616 |
| Inventory | 11,227 | 14,341 | 17,264 | 19,106 | 20,878 |
| Loans & advances | 402 | 436 | 469 | 519 | 566 |
| Other current assets | 6,525 | 7,974 | 8,771 | 9,649 | 10,613 |
| Total current assets | 42,947 | 54,188 | 63,869 | 92,154 | 122,495 |
| Investments | 12,204 | 13,424 | 14,766 | 16,243 | 17,867 |
| Gross fixed assets | 154,669 | 164,669 | 174,669 | 184,669 | 194,669 |
| Less: Depreciation | -94,339 | -100,909 | -108,539 | -116,619 | -125,150 |
| Add: Capital WIP | 873 | 1,286 | 1,286 | 1,286 | 1,286 |
| Net fixed assets | 60,330 | 63,760 | 66,130 | 68,049 | 69,519 |
| Total assets | 213,394 | 227,158 | 250,600 | 280,805 | 312,615 |
| Current liabilities | 52,953 | 56,921 | 62,821 | 69,101 | 75,239 |
| Provisions | 3,385 | 3,738 | 3,089 | 4,642 | 4,874 |
| Total current liabilities | 56,337 | 60,659 | 65,909 | 73,744 | 80,114 |
| Non-current liabilities | -772 | -552 | -552 | -552 | -552 |
| Total liabilities | 55,565 | 60,107 | 65,358 | 73,192 | 79,562 |
| Paid-up capital | 399.6 | 399.7 | 399.7 | 399.7 | 399.7 |
| Reserves & surplus | 157,430 | 166,651 | 184,842 | 207,214 | 232,653 |
| Shareholders' equity | 157,829 | 167,051 | 185,242 | 207,613 | 233,053 |
| Total equity & liabilities | 213,394 | 227,158 | 250,600 | 280,805 | 312,615 |

| Cash Flow | | | | | |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|
| YE: Mar (INR mn) | FY22 | FY23 | FY24E | FY25E | FY26E |
| Pre-tax profit | 32,501 | 38,745 | 52,862 | 60,202 | 64,239 |
| Depreciation | 6,498 | 6,570 | 7,630 | 8,080 | 8,530 |
| Chg in working capital | -1,768 | -7,873 | -2,003 | 3,955 | 561 |
| Total tax paid | -7,979 | -9,419 | -12,687 | -14,449 | -15,417 |
| CFO | 21,443 | 22,569 | 37,528 | 49,349 | 49,300 |
| Capital expenditure | -6,042 | -10,412 | -10,000 | -10,000 | -10,000 |
| Chg in investments | -1,526 | -3,580 | - | - | - |
| Other investing activities | 5,569 | 5,652 | 8,477 | 8,647 | 8,743 |
| CFI | -2,000 | -8,341 | -1,523 | -1,353 | -1,257 |
| Free cash flow | 13,874 | 8,576 | 27,528 | 39,349 | 39,300 |
| Debt raised/(repaid) | 0 | 0 | 0 | 0 | 0 |
| Dividend (incl. tax) | -22,208 | -23,380 | -21,984 | -23,382 | -23,382 |
| CFF | -22,466 | -23,579 | -22,186 | -23,589 | -23,589 |
| Net chg in cash | (3,023) | (9,351) | 13,819 | 24,407 | 24,454 |
| Opening cash balance | 4,438 | 1,751 | 3,455 | 5,883 | 30,290 |
| Closing cash balance | 1,751 | 3,455 | 5,883 | 30,290 | 54,822 |

| Ratios | | | | | |
|--------------------------|-------|-------|-------|-------|-------|
| YE: Mar | FY22 | FY23 | FY24E | FY25E | FY26E |
| EPS (INR) | 124 | 146 | 201.0 | 220.9 | 244.3 |
| PER (x) | 24.7 | 21.0 | 15.2 | 13.8 | 12.5 |
| Price/Book (x) | 3.9 | 3.7 | 3.3 | 2.9 | 2.6 |
| EV/EBITDA (x) | 15.2 | 12.8 | 9.7 | 8.3 | 7.2 |
| EV/Net sales (x) | 1.8 | 1.5 | 1.4 | 1.2 | 1.0 |
| RoE (%) | 16.0 | 17.9 | 22.8 | 22.5 | 22.2 |
| RoCE (%) | 21.2 | 24.1 | 30.2 | 30.0 | 29.3 |
| Fixed Asset turnover (x) | 1.9 | 2.1 | 2.1 | 2.2 | 2.3 |
| Dividend Yield (%) | 3.1 | 3.3 | 3.3 | 3.3 | 3.3 |
| Receivable (days) | 29 | 30 | 31 | 29 | 29 |
| Inventory (days) | 16 | 18 | 20 | 20 | 20 |
| Payable (days) | 60 | 58 | 60 | 60 | 60 |
| Net D/E ratio (x) | (0.6) | (0.6) | (0.5) | (0.6) | (0.6) |

Source: Arianth Research, Company Filings

Arihant Research Desk

Email: research@arihantcapital.com

Tel. : 022-42254800

| Head Office | Registered Office |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|
| #1011, Solitaire Corporate Park Building No. 10, 1 st Floor Andheri Ghatkopar Link Road Chakala, Andheri (E) Mumbai – 400093 Tel: (91-22) 42254800 Fax: (91-22) 42254880 | Arihant House E-5 Ratlam Kothi Indore - 452003, (M.P.) Tel: (91-731) 3016100 Fax: (91-731) 3016199 |

| Stock Rating Scale | Absolute Return |
|--------------------|-----------------|
| BUY | >20% |
| ACCUMULATE | 12% to 20% |
| HOLD | 5% to 12% |
| NEUTRAL | -5% to 5% |
| REDUCE | -5% to -12% |
| SELL | <-12% |

| Research Analyst Registration No. | Contact | Website | Email Id |
|-----------------------------------|-------------------------|--------------------------------------------------------------------|------------------------------------------------------------------------------|
| INH000002764 | SMS: 'Arihant' to 56677 | www.arihantcapital.com | research@arihantcapital.com |

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Arihant Capital Markets Ltd.
1011, Solitaire Corporate park, Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road, Chakala, Andheri (E)
Tel. 022-42254800 Fax. 022-42254880