

2-W space yet to show sustained volume recovery...

About the stock: Hero MotoCorp (HMCL) is the world's largest 2-W manufacturer by volume, with domestic market share at 34.5% as of FY22. Its suite of popular models includes Splendor, Passion, Glamour, etc.

- Rural geographies form ~50% sales; 48.3% FY22 motorcycle market share
- Debt-free b/s with strong return ratios; healthy >50% dividend payout ratio
- On ground EV presence currently limited to ~35% stake in Ather Energy

Q1FY23 Results: The company reported a muted performance in Q1FY23.

- Total sales came in at ₹ 8,393 crore up 13.1% QoQ, volumes up 16.9% QoQ
- EBITDA came in at ₹ 941 crore with margins at 11.2% flat QoQ. Gross margin decline for the quarter was at ~350 bps QoQ
- Consequent standalone PAT was at ₹ 624.4 crore, flat QoQ

What should investors do? HMCL's share price has lagged Nifty Auto Index in the past five years, de-growing at ~7.1% CAGR from ~₹ 3,986 levels in August 2017.

- We maintain **HOLD** amid muted margin performance, mellow commitment towards EV space & await volume ramp-up during upcoming festive season

Target Price and Valuation: We value HMCL at revised target price of ₹ 2,925 (15x P/E on FY24E EPS & 2.5x P/B to its long term strategic investments in FY24E)

Key triggers for future price performance:

- We expect volume to grow at a CAGR of 8.0% over FY22-24E, driven by need for personal mobility & revival in urban demand. Consequently, revenues are seen growing at 11.5% CAGR over FY22-24E
- With positive operating leverage, cooling off in commodity & higher spares revenues, margins are seen reaching 12.5% by FY24E
- Exports, spares and Harley tie-up to aid diversification & product mix
- Own EV launch by festive season, prominent presence in Ather along with partnership with Gogoro complementing co.'s presence in EV space

Alternate Stock Idea: Besides HMCL, in our auto OEM coverage, we like M&M.

- Focused on prudent capital allocation, UV differentiation & EV proactiveness
- BUY with target price of ₹ 1,550



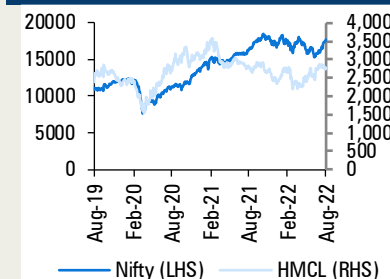
Particulars

Particular	Amount
Market Capitalization	₹ 55117.2 Crore
Total Debt (FY22)	₹ 0 Crore
Cash & Inv. (FY22)	₹ 8449 Crore
EV	₹ 46668 Crore
52 week H/L (₹)	2954 / 2147
Equity capital (₹ crore)	40.0
Face value	₹ 2

Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	34.8	34.8	34.8	34.8
FII	32.3	29.6	29.2	28.8
DII	22.0	23.7	24.2	25.6
Other	11.0	12.0	11.8	10.8

Price Chart



Recent event & key risks

- Posted muted Q1FY23 results
- **Key Risk:** (i) Competitive and innovative offering in the EV space (ii) Slower than expected uptick in rural demand.

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Key Financial Summary

Key Financials	FY19	FY20	FY21	FY22	5 year CAGR (FY17-22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Net Sales	33,650.5	28,836.1	30,800.7	29,245.5	0.5%	33,401.2	36,379.7	11.5%
EBITDA	4,929.8	3,958.0	4,019.2	3,368.7	-6.2%	3,867.7	4,551.5	16.2%
EBITDA Margins (%)	14.6	13.7	13.0	11.5		11.6	12.5	
Net Profit	3,384.6	3,633.3	2,964.1	2,472.9	-6.0%	2,741.6	3,288.1	15.3%
Normalised Net Profit	3,384.6	3,202.6	2,964.1	2,472.9	-6.0%	2,741.6	3,288.1	15.3%
EPS (₹)	169.5	181.9	148.4	123.8		137.3	164.7	
P/E	16.3	15.2	18.6	22.3		20.1	16.8	
RoNW (%)	26.3	22.7	19.5	15.7		16.6	19.0	
RoCE (%)	32.0	21.3	20.8	16.3		18.4	21.1	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q1FY23 Results:

- Blended ASP for the quarter was at ~ ₹ 60,370/unit (down 3.3% QoQ). This looks optically down QoQ but adjusted for lower spare parts revenues and other operating income it is up 1.5% QoQ at ~₹ 52,000/unit
- EBITDA in Q1FY23 was at ₹ 941 crore, up 13.7% QoQ with corresponding EBITDA margins at 11.2% (flat QoQ). The company witnessed ~350 bps gross margins decline on a QoQ basis. The decline, however, was negated by lower other expenses, which were down ~350 bps QoQ at 9.6% of sales
- HMCL's gross margin decline was on a higher side vs. its peers
- PAT for the quarter came in at ₹ 624.4 crore, flat QoQ

Q1FY23 Earnings Conference Call highlights

- HMCL continues to remain optimistic about domestic demand. Further recovery was witnessed in sales with improvement in market share.
- HMCL EV launch will be as planned in festive season with dispatch schedules and cities unveiled during launch itself
- Spares revenue was at ₹ 1061 crore i.e. ~12.6% of topline vs ~₹ 1,151 crore in Q4FY22. Dip in spares revenue was largely attributed to year end effect with management expects ~13-14% annual run rate
- The company is witnessing good traction in premium products like Pleasure XTEC, Splendor XTEC where in demand is outpacing supply
- Gross margin decline was tracking commodity inflation kicking in with quarterly lag. Further, to offset the same the company took ~₹ 850 hike during Q1FY23 and ~₹ 1,250 per bike on July 1, 2022. However, still some part of hiked input cost remained unabsorbed
- Hero FinCorp financing arm of HMCL is currently operating at ~7% credit cost with focus to reduce to 5-5.5% to improve return on assets & is currently undergoing funding round to increase AUM
- Exports for the quarter remained soft due to geopolitical issues and adverse economic conditions in Nepal, Sri Lanka but the management expects H2FY23 to be better for exports
- The management expects margin to improve post cooling of raw material process and revival in demand leading to outsized operating leverage gains
- The management foresees demand to be healthy in FY23 riding on the back of strong marriage season, pick-up in rural demand and coming festive season. Present inventory levels are at six to eight weeks with the management planning to increase in run up to the festive season in Q2FY23

The management intends to grow double digit in volumes in FY23E

MTM loss in other income was ~₹ 60 crores (including ~₹ 25 crore unrealised loss in Gogoro shares)

Company's stake in Ather Energy on diluted basis was at ~35%

Other operating income for the quarter was at ₹ 109 crore vs. ₹ 186 crore and was largely due to expiration of fiscal incentives for its Neemrana plant (Rajasthan)

In Q1FY23 retails were higher than wholesale

Chip shortage impacted volume of the premium variants, which are in general priced at ~7-10% premium to their base variant

The management expects rural income to be healthy despite weak monsoon in some of its key states namely UP, Bihar among others

Replacement demand share at ~15-18% with its intent to increase it to 20%+ in coming years

On the space front, its retail footprint has improved from 39,000 earlier to 40,000 now

Financing penetration stands at >50%

Peer comparison

Exhibit 1: Peer Comparison (2-W)

Company	CMP	TP	Rating	Mcap	2-W Lakh volumes			EBITDA margin (%)			RoCE (%)			P/E		
	₹	₹			₹ crore	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E
Bajaj Auto (BAAUTO)	4,031	4,180	Hold	1,16,651	38.4	41.6	45.1	15.9	17.5	18.0	18.4	27.1	29.3	23.2	18.5	16.3
Hero Moto (HERHON)	2,760	2,925	Hold	55,117	49.4	54.4	57.6	11.5	11.6	12.5	16.3	18.4	21.1	22.3	20.1	16.8
Eicher Motors (EICMOT)	3,214	3,650	Buy	87,828	6.0	7.8	9.0	21.1	24.7	26.1	13.3	19.6	20.5	52.4	32.5	26.7

Source: Company, ICICI Direct Research; Note – Bajaj Auto sales volumes above are for its 2-W division only

In the 2-W auto OEM space, we ascribe BUY rating to Eicher Motors amid launch of affordable offering in the premium motorcycle segment and assign HOLD rating to other incumbent 2-W auto OEMs. We await firm volume growth (monthly numbers) as well as more meaningful action from them on EV front before turning decisively positive.

Exhibit 2: Variance Analysis

	Q1FY23	Q1FY23E	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	Comments
Total Operating Income	8,393	8,852	5,487	53.0	7,422	13.1	Topline came in lower than our estimates tracking lower than anticipated ASPs
Raw Material Expenses	6,107	6,163	3,980	53.5	5,142	18.8	RM costs came in higher and were up 350 bps QoQ to 72.8% of sales
Employee Expenses	538	531	436	23.5	476	13.0	
Other expenses	806	1,062	557	44.8	975	-17.3	Other expenses came in lower at 9.6% of sales
Operating Profit (EBITDA)	941	1,095	515	82.7	828	13.7	
EBITDA Margins (%)	11.2	12.4	9.4	180 bps	11.2	10 bps	EBITDA margins came in lower than anticipated at 11.2% of sales vs. our estimate of 12.4%
Other Income	53	146	139	-61.8	140	-62.1	Other income came in lower due to MTM loss on investments incl. treasury book
Interest	7.0	6.4	6.1	14.6	6.7	4.8	
Depreciation	163.0	173.6	163.0	0.0	158.5	2.9	Depreciation was broadly on expected lines
PBT after Exceptional Items	823.6	1,060.9	484.3	70.1	802.2	2.7	
Total Tax	199.3	267.3	118.9	67.6	175.2	13.8	
PAT	624.4	793.5	365.4	70.9	627.1	-0.4	PAT was largely flat on QoQ basis and was lower than our estimates tracking miss on margins
EPS (Adjusted)	31.3	39.7	18.3	70.9	31.4	-0.4	
Key Metrics							
Total 2-W Sales (lakh units)	13.9	13.9	10.2	35.7	11.9	16.9	2-W sales volume for Q1FY23 at 13.9 lakh units, up 16.9% QoQ
Net Blended ASP (₹/unit)	60,370	63,675	53,558	12.7	62,426	-3.3	ASPs came in lower at ₹ 60,370/unit, down 3.3% QoQ vs. our estimates of ₹ 63,675/unit primarily tracking sequential decline in spare parts revenues as well as other operating income

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	34,644	33,401	-3.6	37,258	36,380	-2.4	Broadly retained our estimates. We expect topline at the company to grow at a CAGR of 11.5% over FY22-24E
EBITDA	4,315	3,868	-10.4	4,862	4,552	-6.4	
EBITDA Margin (%)	12.5	11.6	-88 bps	13.0	12.5	-54 bps	Marginally lowered our margin estimates tracking muted performance in Q1FY23
PAT	3,118	2,742	-12.1	3,521	3,288	-6.6	
EPS (₹)	156.1	137.3	-12.1	176.3	164.7	-6.6	Lowering of margin estimates led to downward revision in PAT estimates for FY23-24E

Source: ICICI Direct Research

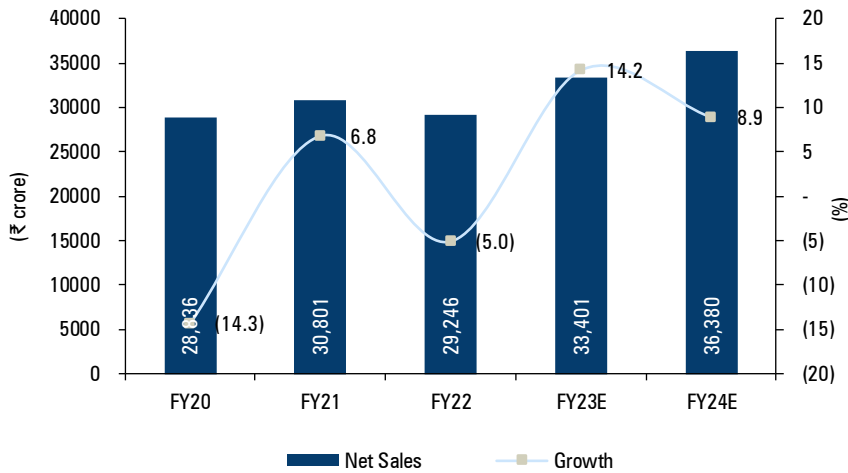
Exhibit 4: Assumptions

	Current				Earlier				Comments
	FY19	FY20	FY21	FY22	FY23E	FY24E	FY23E	FY24E	
Motorcycle volumes (lakh units)	71	60	53	46	51	54	51	54	Broadly retained our volume estimates wherein we expect volumes at the company to grow 10% YoY in FY23E (albeit on a low base) and thereafter grow 6% YoY in FY24E. Two year volume CAGR is placed at 8% CAGR led by growth in the motorcycle segment
Scooter volumes (lakh units)	7	4	5	3	3	3	3	4	
Total volumes (lakh units)	78	64	58	49	54	58	54	58	
Growth (% YoY)		-18.0%	-9.8%	-14.5%	10.0%	6.0%			
Gross Blended ASP (₹/unit)	43,026	44,988	53,244	59,152	61,416	63,121	63,675	64,627	

Source: ICICI Direct Research

Financial story in charts

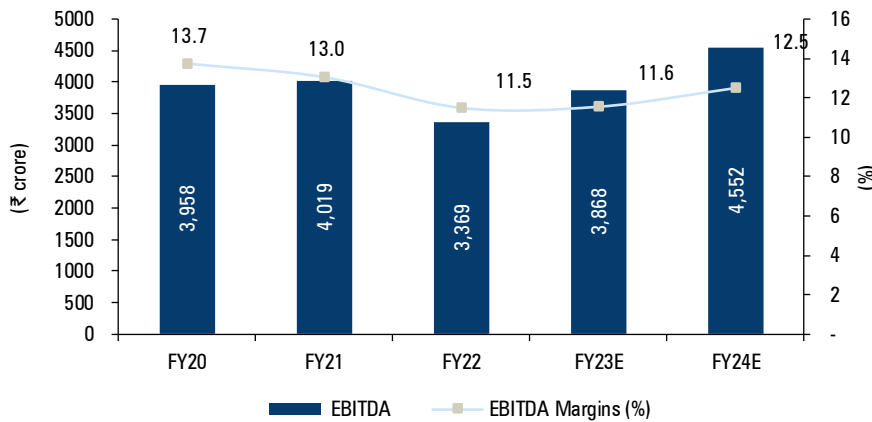
Exhibit 5: Topline trend



We expect sales to grow at a CAGR of 11.5% over FY22-24E backed by 8% volume CAGR

Source: Company, ICICI Direct Research

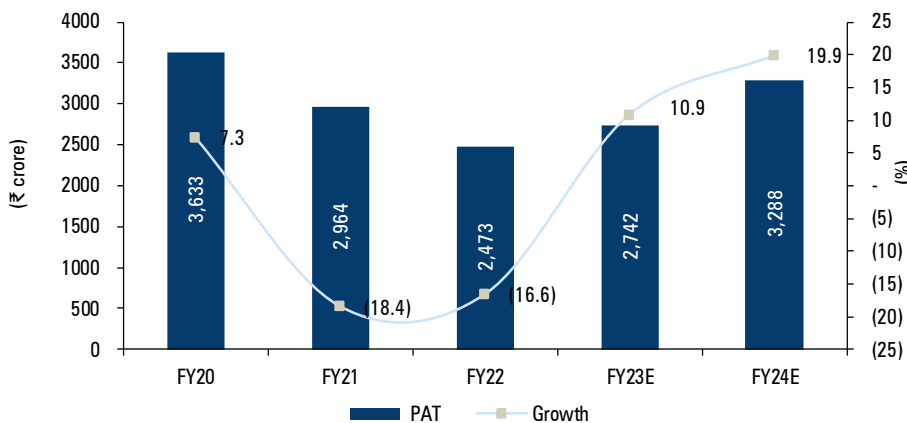
Exhibit 6: Trend in margins



Margins are seen remaining resilient around the ~12.5% mark by FY24E

Source: Company, ICICI Direct Research

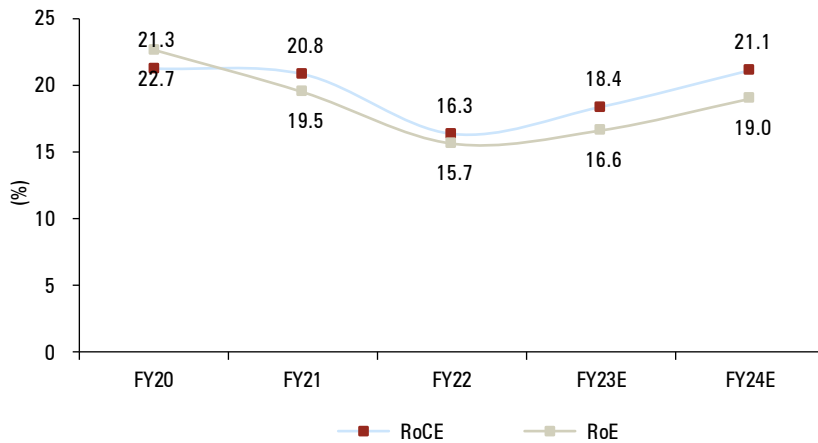
Exhibit 7: Trend in profitability



PAT is expected to grow to ₹ 3,288 crore in FY24E

Source: Company, ICICI Direct Research

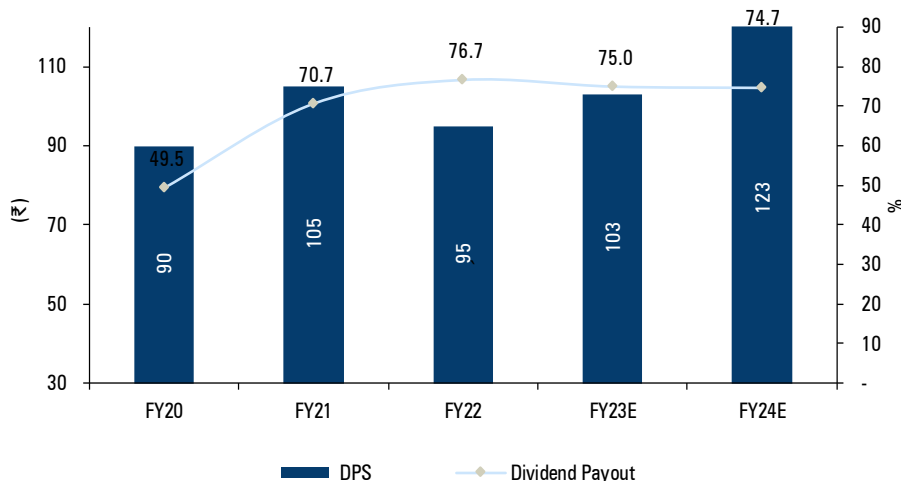
Exhibit 8: Trend in return ratios



Return ratios are expected to be ~20-21% in FY24E

Source: Company, ICICI Direct Research

Exhibit 9: Trend in dividend payout



High dividend payout is the USP at HMCL. The same is expected to continue. HMCL offers a lucrative dividend yield of ~3.5-4%

Source: Company, ICICI Direct Research

Exhibit 10: Valuation Summary

	Sales (₹ cr)	Growth (%)	EPS (₹ cr)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	32,230.5	(3.5)	185.1	34.9	14.9	9.2	31.4	38.1
FY19	33,650.5	4.4	169.5	-8.5	16.3	10.3	26.3	32.0
FY20	28,836.1	(14.3)	181.9	7.3	15.2	12.3	22.7	21.3
FY21	30,800.7	6.8	148.4	-18.4	18.6	11.6	19.5	20.8
FY22	29,245.5	-5.0	123.8	-16.6	22.3	13.9	15.7	16.3
FY23E	33,401.2	14.2	137.3	10.9	20.1	12.2	16.6	18.4
FY24E	36,379.7	8.9	164.7	19.9	16.8	10.3	19.0	21.1

Source: Company, ICICI Direct Research

Exhibit 11: SoTP Valuation

Particulars	Amount (₹)
FY24E Core EPS (₹/share, A)	164.7
P/E Multiple assigned (x, B)	15.0
Value of Base Business (C = A*B)	2,470
Other investment like Hero Fincorp & Ather Energy (₹ crore as of FY24E, D)	3,629
P/B Multiple Assigned (x, E)	2.5
Value of long term Investments (₹ crore, F = D*E)	9,072
Per share value of long term investments (G)	455
Target Price (C+G)	2,925
Potential Upside (%)	6%

Source: ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Total operating income	30,800.7	29,245.5	33,401.2	36,379.7
Growth (%)	6.8	-5.0	14.2	8.9
Raw Material Expenses	21,762.3	20,826.7	24,187.1	26,079.6
Employee Expenses	1,898.8	1,935.4	2,038.7	2,110.0
Other expenses	3,120.3	3,114.5	3,307.1	3,638.0
Total Operating Expenditure	26,781.5	25,876.8	29,533.1	31,827.8
EBITDA	4019.2	3368.7	3868.1	4551.9
Growth (%)	1.5	-16.2	14.8	17.7
Depreciation	676.9	649.8	681.4	709.4
Interest	21.9	25.8	27.7	29.1
Other Income	579.9	556.9	495.6	582.8
PBT	3900.3	3250.0	3654.2	4395.8
Total Tax	936.2	777.1	912.6	1,107.7
PAT	2964.1	2472.9	2741.6	3288.1
Growth (%)	-18.4	-16.6	10.9	19.9
Normalised PAT (₹)	2,964.1	2,472.9	2,741.6	3,288.1
EPS (₹)	148.4	123.8	137.3	164.7

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit after Tax	2,964.1	2,472.9	2,741.6	3,288.1
Add: Depreciation & Interest	698.7	675.6	709.1	738.5
Sub: Other Income	579.9	556.9	495.6	582.8
(Inc)/dec in Current Assets	-1,151.9	384.5	-789.4	-437.8
Inc/(dec) in CL and Provisions	2,134.2	-1,037.8	894.4	532.1
CF from operating activities	4065.2	1938.2	3060.0	3538.1
(Inc)/dec in Investments	-1,892.5	-137.6	525.0	-350.0
(Inc)/dec in Fixed Assets	-643.6	-489.4	-1,010.0	-1,010.0
Others	-169.8	-35.9	-980.0	-230.0
Add: Other Income	579.9	556.9	495.6	582.8
CF from investing activities	-2126.0	-106.0	-969.4	-1007.2
Inc/(dec) in loan funds	0.0	0.0	0.0	0.0
Dividend paid & dividend tax	-2,096.9	-1,897.2	-2,056.9	-2,456.3
Inc/(dec) in Sec. premium & Othe	172.8	-17.1	-27.7	-29.1
CF from financing activities	-1924.0	-1914.3	-2084.6	-2485.4
Net Cash flow	15.3	-82.0	6.1	45.5
Opening Cash	241.9	257.1	175.2	181.2
Closing Cash	257.1	175.2	181.2	226.7

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Liabilities				
Equity Capital	40.0	40.0	40.0	40.0
Reserve and Surplus	15,158.5	15,743.0	16,427.7	17,259.5
Total Shareholders funds	15198.4	15782.9	16467.6	17299.4
Total Debt	0.0	0.0	0.0	0.0
Deferred Tax Liability	404.1	383.3	393.3	403.3
Others	448.3	475.4	485.4	495.4
Total Liabilities	16050.8	16641.6	17346.4	18198.1
Assets				
Gross Block	10,714.3	11,173.8	12,198.8	13,223.8
Less: Acc Depreciation	5,016.1	5,665.8	6,347.2	7,056.6
Net Block	5698.2	5508.0	5851.6	6167.2
Capital WIP	177.9	87.3	62.3	37.3
Total Fixed Assets	5,876.0	5,595.3	5,913.9	6,204.5
Investments	10,499.7	10,652.3	11,127.3	11,727.3
Inventory	1,469.6	1,122.7	1,372.7	1,495.1
Debtors	2,426.8	2,304.3	2,745.3	2,990.1
Loans and Advances	36.9	40.2	46.0	50.1
Cash	257.1	175.2	181.2	226.7
Total Current Assets	4,761.3	4,294.8	5,090.3	5,573.6
Creditors	5,204.6	4,260.4	5,033.1	5,481.9
Provisions	160.4	160.4	189.5	206.4
Total Current Liabilities	6,110.2	5,072.4	5,966.8	6,498.9
Net Current Assets	-1,348.9	-777.6	-876.5	-925.3
Application of Funds	16050.8	16641.6	17346.4	18198.1

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	148.4	123.8	137.3	164.7
Cash EPS	182.3	156.4	171.4	200.2
BV	761.1	790.3	824.6	866.3
DPS	105.0	95.0	103.0	123.0
Cash Per Share	420.3	423.1	397.1	416.9
Operating Ratios (%)				
EBITDA Margin	13.0	11.5	11.6	12.5
PBT / Net sales	10.9	9.3	9.5	10.6
PAT Margin	9.6	8.5	7.4	8.1
Inventory days	17.4	14.0	15.0	15.0
Debtor days	28.8	28.8	30.0	30.0
Creditor days	61.7	53.2	55.0	55.0
Return Ratios (%)				
RoE	19.5	15.7	16.6	19.0
RoCE	20.8	16.3	18.4	21.1
RoIC	44.7	33.5	34.1	39.1
Valuation Ratios (x)				
P/E	18.6	22.3	20.1	16.8
EV / EBITDA	11.6	13.9	12.2	10.3
Market Cap / Sales	1.8	1.9	1.7	1.5
Price to Book Value	3.6	3.5	3.3	3.2
Solvency Ratios				
Current Ratio	0.8	0.9	0.9	0.9
Quick Ratio	0.5	0.7	0.7	0.7

Source: Company, ICICI Direct Research

Exhibit 16: ICICI Direct coverage universe (Auto & Auto Ancillary)

Sector / Company	CMP			M Cap	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)	Rating		(₹ Cr)	FY22P	FY23E	FY24E	FY22P	FY23E	FY24E	FY22P	FY23E	FY24E	FY22P	FY23E	FY24E	FY22P	FY23E
Apollo Tyre (APOTYR)	234	230	Buy	14,838	10.1	12.7	19.4	23.2	18.4	12.0	7.5	6.6	5.0	6.3	7.3	10.3	5.4	6.6	9.4
Ashok Leyland (ASHLEY)	146	180	Buy	42,706	1.8	1.7	4.8	79.0	85.3	30.6	44.1	26.9	15.2	2.1	7.6	17.7	0.2	6.5	17.1
Bajaj Auto (BAAUTO)	4,031	4,180	Hold	1,16,651	173.4	218.4	247.2	23.2	18.5	16.3	18.1	13.5	11.7	18.4	27.1	29.3	17.6	24.5	26.3
Balkrishna Ind. (BALIND)	2,171	2,550	Buy	41,971	73.0	65.3	98.3	29.8	33.2	22.1	22.1	23.1	15.2	15.9	13.1	19.7	20.4	16.0	20.4
Bharat Forge (BHAFOR)	790	900	Buy	36,780	23.1	19.8	28.3	34.1	39.9	27.9	19.8	19.3	15.1	9.6	9.2	12.2	15.2	12.7	16.1
Eicher Motors (EICMOT)	3,214	3,650	Buy	87,828	61.3	99.0	120.2	52.4	32.5	26.7	36.6	22.9	18.7	13.3	19.6	20.5	13.3	18.7	19.7
Escorts Kubota (ESCORT)	1,688	1,650	Hold	22,267	55.8	56.4	71.9	30.2	29.9	23.5	18.3	18.6	14.5	10.4	8.8	10.1	9.3	8.7	10.2
Hero Moto (HERHON)	2,760	2,925	Hold	55,117	123.8	137.3	164.7	22.3	20.1	16.8	13.9	12.2	10.3	16.3	18.4	21.1	15.7	16.6	19.0
M&M (MAHMAH)	1,266	1,550	Buy	1,57,333	41.4	48.7	60.6	30.6	26.0	20.9	21.6	17.3	13.7	9.3	11.4	13.9	13.1	13.5	14.9
Maruti Suzuki (MARUTI)	8,699	10,000	Buy	2,62,784	124.7	236.8	333.3	69.8	36.7	26.1	39.0	21.9	15.9	5.1	11.5	15.2	7.0	12.1	15.3
Uno Minda (MININD)	564	650	Buy	32,238	6.2	10.0	13.6	90.6	56.2	41.5	37.1	28.5	22.7	10.2	13.4	16.9	10.3	14.5	16.7
Tata Motors (TATMOT)	477	530	Buy	1,82,509	-29.9	-9.5	17.9	-16.0	-49.9	26.6	7.6	6.3	4.7	4.8	8.2	14.5	-23.5	-8.1	13.2

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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