

Aiming to improve in Scooters, Premium & Exports

Scooters to get electrified faster, HMCL has a multi-pronged approach

We hosted the senior management of HMCL – Dr. Pawan Munjal, Chairman, Managing Director & CEO, and Mr. Niranjan Gupta, CFO. We discussed the road ahead for 2Ws, its strategy, and roadmap for electrification. Key highlights:

Focus on improving weaknesses viz Scooters, premium Motorcycle and exports

- HMCL has a clear and solid focus on premium Motorcycles, Scooters, and exports. In these three areas, there are steep internal targets for market share/volume contribution. It is focused on achieving its targeted market share in these categories and has a strategy in place to attain this profitably. It is already inching up its market share in Scooters and premium Motorcycles.
- One of the biggest differentiators for HMCL during these COVID-19 times has been its range of new products in these areas. New premium products are doing very well and helping it improve its market share. Extreme 160R, New Passion Pro, variants like Glamour, Blaze, and Pleasure Platinum has become volume drivers and improved its presence in urban markets.
- In the global business, it has put in place infrastructure and a market-specific product strategy is being executed. It has set huge targets of achieving a certain contribution of volumes from exports, as a percentage of total volume coming in from global market. Mr. Sanjay Bhan (erstwhile National Sales Head) is leading HMCL's export initiatives.

Harley Davidson (HD) partnership: One of its kind partnership in HDs history

- HMCL has recently entered into a partnership with Harley-Davidson (HD) for: a) distribution of Motorcycles, parts, and official merchandise, and b) design, development, and manufacture of a range of motorcycles to be sold under the latter's brand. This is huge and massive endorsement of its R&D and manufacturing capabilities.
- In HD's 117 year history, this is the first time they have granted such a license to anyone.
- All the concerned teams are actively working towards a smooth transition for the customers, while simultaneously building plans for coming years. HMCL has already onboarded nearly a dozen HD dealers (from its existing dealer pool) and the process of integration is going on. It will start distributing HD's products from Jan'21.
- HMCL already has designs on the drawing board and has started working with HD. It is couple of years away for production and sales of HMCL designed HD products.

EVs: Scooters ripe for electrification

- As per Dr. Munjal, electrification is here to stay and in times to come, customers would demand clean energy vehicles. In EVs, HMCL has a three pronged approach:- a) Ather Energy, b) in-house development, and c) own start-up (Hero Hatch - incubator). It will soon be showcasing its own electric product.
- There is continuous pressure from the government for the use of alternate fuels like ethanol, methanol, etc. Apart from EVs, there will be more propulsion systems on the road.
- It expects Scooters to get electrified first as it is easy to electrify rather than Motorcycles. The company also expects 3Ws to get electrified faster and could be a good opportunity.

Hero MotoCorp



Dr. Pawan Munjal,
Chairman, Managing
Director & CEO, Hero
MotoCorp

Dr. Pawan Munjal is one of India's foremost corporate leaders, championing growth, socio-economic progress, and technological innovations. He joined Hero Honda Motors in the early 1980s as a Director and took over as Managing Director in 2001. Dr. Munjal has successfully overseen the transition from Hero Honda to HMCL in 2011.

- While it is aiming for an increase its market share in ICE scooters, electrification of Scooters augurs well for HMCL as it has just 12% market share in ICE scooters. It doesn't see a conflict of interest as the company has a separate business unit for EVs (EMBU - Emerging Mobility Business Unit) and not part of the core business.

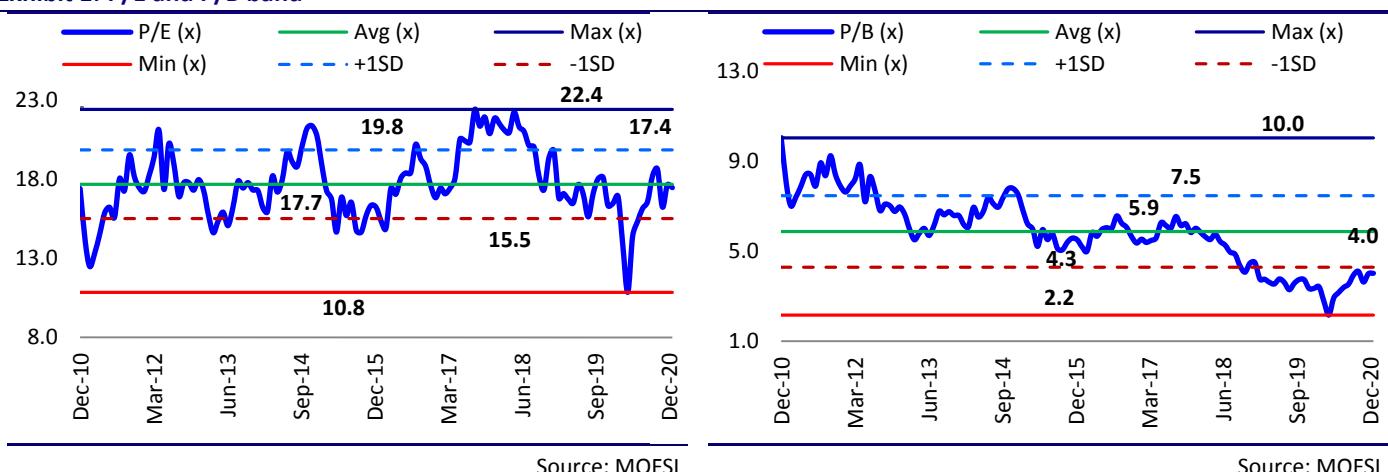
Other takeaways

- 2W penetration levels in India are still very low relative to some other markets (like China). Unlike some countries, where customers move directly to 4Ws, India would first move to 2Ws on motorized transport.
- One of the KPIs of Dr. Munjal is the development of people/talent and succession in the company. In recent times, it has set-up internal processes to develop talent internally.
- Sustainability is an important focus for HMCL. It was recently listed in Dow Jones Sustainability Emerging Markets Index and it is the only 2W company from India to be included in this index (only 14 Indian companies part of this index).

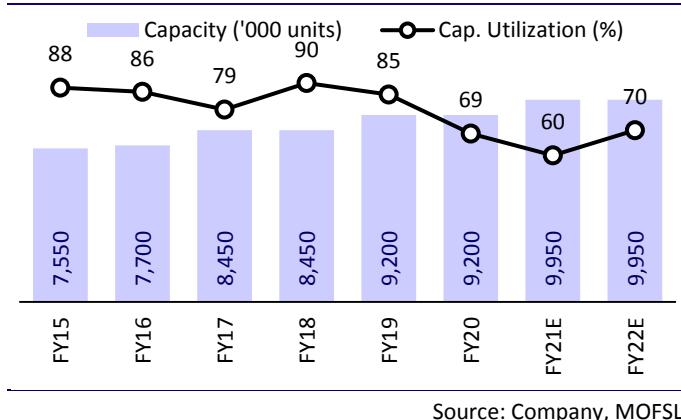
Valuation and view

- HMCL is in a sweet spot as strong rural-led recovery plays to its strength in the economy-executive category in the Motorcycles segment. With an apt product portfolio for the rural market, the highest brand recall, and a strong distribution network, it is best placed to benefit from low penetration and ongoing momentum in the rural economy.
- Unlike the last five years, we expect ~11% EPS CAGR over FY20-23E. The stock currently trades ~16.3x/15x FY22E/FY23E EPS, implying a 20-25% discount to its five-year average P/E of 18x.
- We value HMCL at 18x Dec'22 EPS to factor in improved volume visibility and lower risk of value outflow from HMCL's areas of strength. Maintain Buy with a TP of INR3,750/share (18x Dec-22E EPS + INR100 for Hero FinCorp post 40% holding company discount).

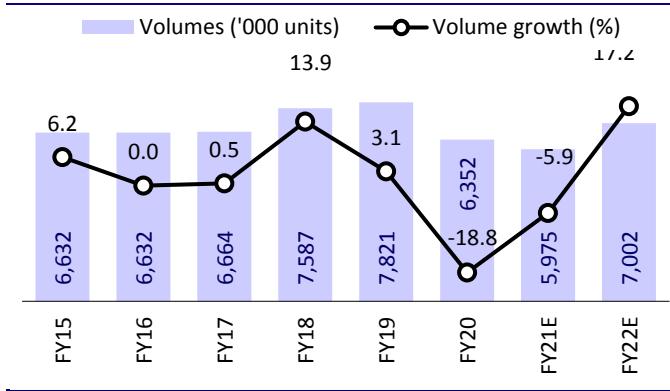
Exhibit 1: P/E and P/B band



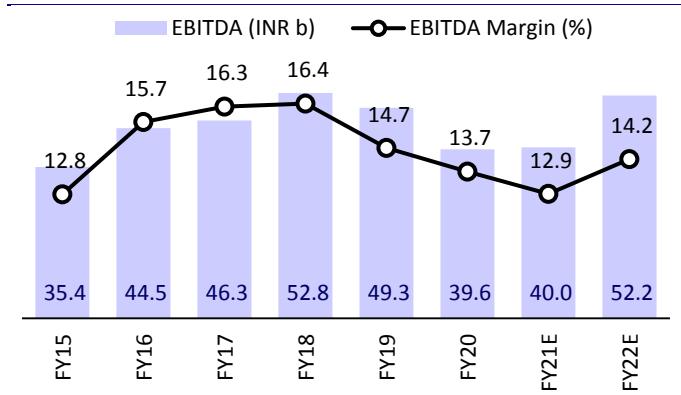
Story in charts

Exhibit 2: Adding capacity ahead of growth


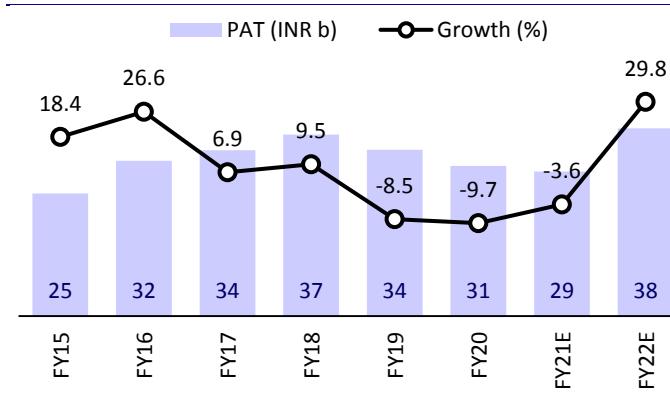
Source: Company, MOFSL

Exhibit 3: Volume sustainability led by rural recovery


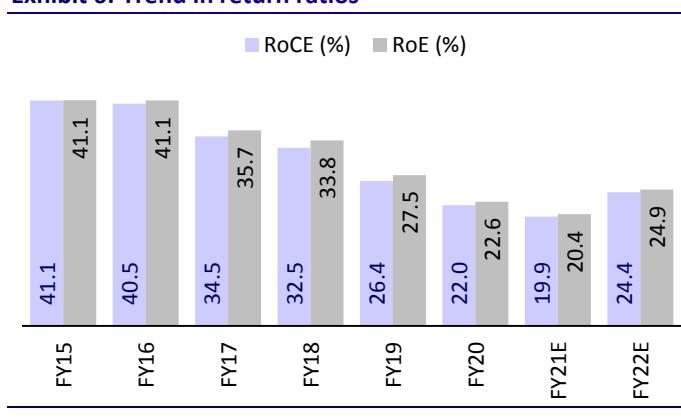
Source: SIAM

Exhibit 4: EBITDA margin trajectory


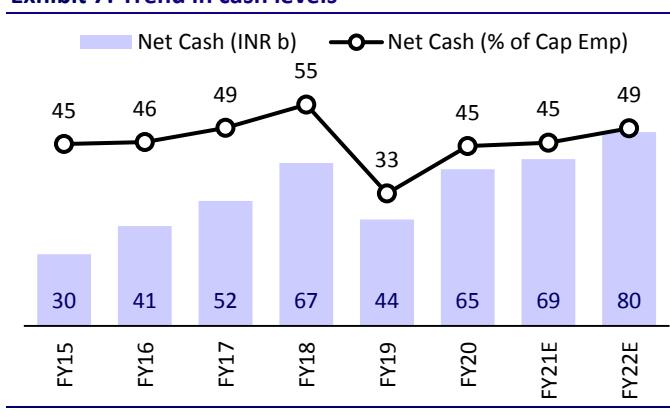
Source: Company, MOFSL

Exhibit 5: PAT growth to be muted


Source: Company, MOFSL

Exhibit 6: Trend in return ratios


Source: Company, MOFSL

Exhibit 7: Trend in cash levels


Source: Company, MOFSL

Exhibit 8: Snapshot of the revenue model

'000 units	FY15	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Total Motorcycles	5,800	5,736	5,834	6,677	7,081	5,990	5,668	6,636
Growth (%)	4.7	-1.1	1.7	14.4	6.0	-15.4	-5.4	17.1
% of total volumes	87.5	86.5	87.5	88.0	90.5	94.3	94.9	94.8
Total Scooters	832	896	830	910	740	361	307	366
Growth (%)	17.6	7.7	-7.4	9.7	-18.7	-51.1	-15.0	19.0
% of total volumes	12.5	13.5	12.5	12.0	9.5	5.7	5.1	5.2
Total volumes	6,632	6,632	6,664	7,587	7,821	6,352	5,975	7,002
Growth (%)	6.2	0.0	0.5	13.9	3.1	-18.8	-5.9	17.2
- of which exports	120	133	141	178	187	162	145	174
% of total volumes	2.0	2.2	2.3	2.6	2.6	2.8	2.7	2.7
Avg. Net Realn. (INR/unit)	41,596	42,886	42,768	42,480	43,027	45,398	52,118	52,438
Growth (%)	2.5	2.4	-0.5	-1.6	0.6	5.3	14.8	0.7
Net revenue (INR b)	276	284	285	322	337	288	311	367
Growth (%)	9.1	3.1	0.2	13.1	4.4	-14.3	8.0	17.9

Source: SIAM, Company, MOFSL

Financials and valuations

Income Statement

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Volumes ('000)	6,632	6,664	7,587	7,821	6,352	5,975	7,002
Volume Growth (%)	0.0	0.5	13.9	3.1	-18.8	-5.9	17.2
Net Revenue	2,84,427	2,85,005	3,22,305	3,36,505	2,88,360	3,11,430	3,67,162
Change (%)	3.1	0.2	13.1	4.4	-14.3	8.0	17.9
EBITDA	44,550	46,348	52,802	49,301	39,579	40,035	52,185
EBITDA Margin (%)	15.7	16.3	16.4	14.7	13.7	12.9	14.2
Depreciation	4,376	4,927	5,556	6,020	8,180	7,006	7,450
EBIT	40,174	41,421	47,246	43,281	31,400	33,029	44,735
Interest cost	49	61	63	86	220	230	250
Other Income	4,224	5,224	5,258	6,913	7,283	5,900	5,940
Non-recurring Expense	0	0	0	0	-7,274	0	0
PBT	44,349	46,585	52,442	50,107	45,736	38,699	50,425
Tax	12,747	12,813	15,468	16,259	9,404	9,255	12,207
Effective Tax Rate (%)	28.7	27.5	29.5	32.4	20.6	23.9	24.2
Adj. PAT	31,602	33,771	36,974	33,849	30,554	29,444	38,218
Change (%)	26.6	6.9	9.5	-8.5	-9.7	-3.6	29.8

Balance Sheet

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Sources of Funds							
Share Capital	399	399	399	400	400	400	400
Reserves	87,945	1,00,714	1,17,289	1,28,172	1,40,965	1,47,491	1,59,172
Net Worth	88,344	1,01,113	1,17,689	1,28,571	1,41,364	1,47,891	1,59,573
Deferred Tax	2,225	4,143	5,117	5,365	3,928	3,928	3,928
Loans	0	0	0	0	0	0	0
Capital Employed	90,569	1,05,256	1,22,805	1,33,936	1,45,292	1,51,819	1,63,501
Application of Funds							
Gross Fixed Assets	91,263	1,03,772	1,11,344	1,16,282	1,38,161	1,36,574	1,44,574
Less: Depreciation	55,420	59,816	64,799	70,097	76,991	83,996	91,447
Net Fixed Assets	35,844	43,956	46,545	46,186	61,171	52,577	53,127
Capital WIP	6,054	4,651	3,184	5,419	3,413	11,000	11,000
Investments	45,810	58,899	75,252	59,686	82,227	82,227	82,227
Curr. Assets, L. and Adv.	38,021	39,438	42,407	65,121	40,683	49,277	68,150
Inventory	6,730	6,563	8,236	10,724	10,920	9,878	11,657
Sundry Debtors	12,828	15,619	15,202	28,216	16,031	20,580	24,286
Cash and Bank Balances	1,314	1,367	1,413	1,365	2,419	6,597	17,784
Loans and Advances	498	725	732	850	896	968	1,143
Others	16,651	15,163	16,823	23,968	10,417	11,254	13,281
Current Liab. & Prov.	35,159	41,686	44,583	42,476	42,201	43,262	51,003
Sundry Creditors	26,506	32,473	33,188	33,553	30,305	32,739	38,635
Other Liabilities	7,681	8,071	9,647	7,161	9,207	8,232	9,714
Provisions	973	1,143	1,747	1,762	2,689	2,292	2,654
Net Current Assets	2,861	-2,249	-2,176	22,646	-1,518	6,015	17,148
Application of Funds	90,569	1,05,256	1,22,805	1,33,936	1,45,292	1,51,819	1,63,501

E: MOFSL estimates

Financials and valuations

Ratios

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Basic (INR)							
EPS	158.2	169.1	185.1	169.5	153.0	147.1	190.9
EPS Growth (%)	26.6	6.9	9.5	-8.5	-9.7	-3.8	29.8
Cash EPS	180.2	193.8	213.0	199.6	222.8	182.1	228.1
Book Value per Share	442.4	506.3	589.3	643.7	707.7	738.7	797.1
DPS	72.0	85.0	95.0	87.0	90.0	95.0	110.0
Payout (Incl. Div. Tax) %	54.8	60.6	61.8	62.9	71.8	77.8	69.4
Valuation (x)							
P/E	19.7	18.4	16.8	18.4	20.4	21.2	16.3
EV/EBITDA	12.9	12.1	10.3	11.4	13.6	13.4	10.0
EV/Sales	2.0	2.0	1.7	1.7	1.9	1.7	1.4
Price to Book Value	7.0	6.2	5.3	4.8	4.4	4.2	3.9
Dividend Yield (%)	2.3	2.7	3.0	2.8	2.9	3.0	3.5
Profitability ratios (%)							
RoE	41.1	35.7	33.8	27.5	22.6	20.4	24.9
RoCE	40.5	34.5	32.5	26.4	22.0	19.9	24.4
RoIC	85.3	77.3	80.0	53.0	40.0	46.0	64.9
Turnover ratios							
Debtors (Days)	17	21	18	32	21	25	25
Inventory (Days)	9	9	10	12	15	12	12
Creditors (Days)	34	42	38	36	38	38	38
Working Capital (Days)	4	-3	-2	25	-2	7	17
Asset Turnover (x)	3.1	2.7	2.6	2.5	2.0	2.1	2.2
Fixed Asset Turnover	3.3	2.9	3.0	3.0	2.3	2.3	2.6

Cash Flow Statement

Y/E March	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E
Profit before Tax	44,349	46,585	52,442	50,107	45,736	38,699	50,425
Depreciation and Amort.	4,376	4,927	5,556	6,020	8,180	7,006	7,450
Direct Taxes Paid	-11,032	-11,865	-14,943	-20,515	-5,443	-9,255	-12,207
(Inc.)/Dec. in Working Capital	2,504	2,504	-1,527	-2,682	-19,189	12,027	-3,354
Other Items	1,834	4,129	1,723	-6,634	-6,399	230	250
CF from Oper. Activity	40,280	40,280	39,809	9,791	54,101	33,326	45,973
Extra-ordinary Items	0	0	0	0	0	0	0
CF after EO Items	40,280	40,280	39,809	9,791	54,101	33,326	45,973
(Inc.)/Dec. in FA+CWIP	-14,604	-11,491	-7,992	-9,179	-13,586	-6,000	-8,000
Free Cash Flow	25,676	28,790	31,816	611	40,515	27,326	37,973
(Pur.)/Sale of Invest.	-8,203	-7,949	-11,160	22,392	-15,245	0	0
CF from Inv. Activity	-22,807	-19,439	-19,152	13,212	-28,831	-6,000	-8,000
Interest Paid	-49	-61	-63	-86	-874	-230	-250
Dividends Paid	-16,818	-20,896	-20,404	-22,854	-23,323	-22,918	-26,537
CF from Fin. Activity	-16,867	-20,956	-20,467	-22,940	-24,198	-23,148	-26,787
Inc./(Dec.) in Cash	606	-116	190	63	1,072	4,178	11,186
Add: Beginning Balance	707	270	154	344	407	1,479	5,657
Closing Balance	1,313	154	344	407	1,479	5,657	16,843

E: MOFSL estimates

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BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
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