

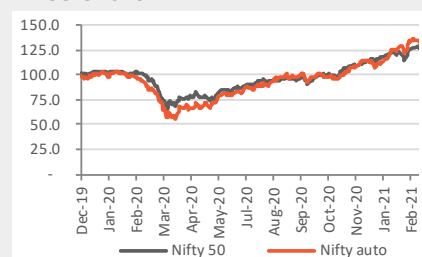
Sector: Automobile
(Two Wheeler Industry)
View: Positive

Coverage universe

| Companies | CMP (Rs) | Reco. | PT (Rs) |
|----------------------------|----------|-------|---------|
| Alicon Castalloy Limited # | 463 | Buy | 500 |
| Amara Raja Batteries | 915 | Buy | 1,146 |
| Apollo Tyres | 250 | Buy | 290 |
| Ashok Leyland | 131 | Buy | 151 |
| Bajaj Auto | 3,901 | Buy | 4,589 |
| Balkrishna Industries | 1,634 | Hold | 1,800 |
| Bosch | 15,297 | Buy | 18,156 |
| Exide Industries \$ | 207 | Buy | 229 |
| GNA Axles | 393 | Buy | 490 |
| Greaves Cotton | 137 | Buy | 150 |
| Hero Motocorp | 3,424 | Buy | 4,030 |
| Lumax Auto Technologies# | 148 | Buy | 150 |
| M&M @ \$ | 852 | Buy | 1,000 |
| Maruti Suzuki | 7,124 | Buy | 9,000 |
| Mayur Uniquoters | 418 | Buy | 500 |
| Schaeffler India | 5,235 | Buy | 5,900 |
| Sundram Fasteners # | 712 | Buy | UR |
| Suprajit Engineering # | 285 | Buy | 300 |
| Tata Motors # | 349 | Buy | 365 |
| TVS Motors \$ | 624 | Buy | 688 |

Source: Company; Sharekhan estimates
 @ MM & MVML; # Consolidated; \$ core business valuation; UR Under Review

Price chart



Source: NSE; Sharekhan Research

We interacted with leading OEMs, dealers and other stakeholders to understand the landscape in India for electric two-wheelers (e-2Ws) in terms of demand-supply, regulatory framework, competition, technology and customer behaviour. The e-2W market in India is at a very nascent stage and its contribution to overall two-wheeler sales is less than 1%. The recent announcement by the government for adoption of electric vehicles through the FAME-II scheme, the 'Go Electric' media campaign and incentive allocation for ACC batteries has given OEMs a moral boost for efforts to promote electric vehicles in India. Despite slower adoption of e-2Ws, the large two-wheeler players are taking big strides on developing technology and supportive infrastructure for electric vehicles. Hero MotoCorp owns a 34.6% stake in Ather Energy, which has an ~11% market share in the e-2W market. Moreover, Hero MotoCorp is developing a mass e-2W product, which is slated to be launched next year. Similarly, Bajaj Auto has launched its e-2W scooter under the iconic brand "Chetak", which used to be the dominant brand in the two-wheelers market two decades ago. Bajaj Auto also holds a 48% stake in its technology partner KTM, which sells ~50,000 e-motorcycles globally. TVS launched its e-2Ws in 2020 and is also expanding its e-scooters in export markets. With Ola electric coming to India for e-2W and setting up largest e-2W capacity, we expect concerns for high lithium ion (Li-Ion) battery will fade off gradually. We expect electric vehicle penetration to remain vibrant in the medium to long run. Requisite support from the government coupled with readiness of OEMs for shifting to a cleaner and greener technology would keep demand robust. Besides electrification of two-wheeler vehicles, we remain positive on the industry owing to strong demand prospects despite COVID-19. Personal transportation is considered a safer option amid COVID-19 and two-wheelers are an affordable choice for buyers. Channel checks suggest strong underlying demand from rural areas, tier-2 and tier-3 cities, which we believe will pave the way for growth. As the economy normalises, we expect a recovery in urban areas as well that would add to overall demand. We expect the two-wheeler industry to outpace other automobile sub-segments, given affordability and personal safety amid COVID-19. Also, structural demand for two-wheelers will drive growth post-normalisation of economic activities, driven by improving personal incomes, increasing penetration in rural economy and two-wheelers being the most preferred mode of personal transportation. We expect the two-wheeler industry to end FY2021 with a decline of 15.6% y-o-y against degrowth of 16.3% y-o-y YTD FY2021, followed by strong 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E. Incremental growth is likely to come from Economy and Executive motorcycle segments, which are slated to grow by 11% y-o-y and 10.4% y-o-y in FY2022E, respectively, largely driven by demand from rural areas and tier2&3 cities. Better-than-expected cost reductions and operational efficiency in Q2 & Q3 of FY21 led to a significant improvement in margins. We expect cost and operational efficiencies to continue to improve the profitability of companies going forward. The two-wheeler market is dominated by Hero MotoCorp with a 35.8% market share, followed by HMTI (27%), TVS Motor (13.8%), and Bajaj Auto (11.9%).

Outlook

The two-wheeler market will continue to dominate the automobile industry, given low affordability; however, within that, we expect the economy and executive segments to remain key growth drivers going forward. We expect premium bikes and scooters to grow in line with the industry, driven by new launches and expected recovery in urban areas. Export markets for two-wheelers remain less affected by COVID-19, as among the top ten export destination only two countries - Colombia and Mexico ranked among the top 15 countries most impacted by COVID-19 pandemic. In FY2020, we expect the two-wheeler segment to grow by 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E, driven by solid demand recovery, low base, affordability and a recovery in key export markets.

In the two-wheeler space, we expect Hero MotoCorp to continue its dominance in the economy and executive motorcycle segment, which contribute the bulk of the motorcycle market size. Hero has an extensive distribution and dealer network in the country and a strong presence in tier-2&3 cities and rural areas from where we expect a large part of incremental demand for two-wheelers. Bajaj Auto is expected to clock growth in the premium bike segment and export markets, given its strong brands in high-growth segments. Product mix should drive better margin performance for Bajaj Auto. Similarly, TVS Motor is expected to perform well led by its new launches and export sales.

Valuation

Despite a run-up in stock prices of two-wheeler companies over the past two quarters, stocks are available below historical multiple averages. The recovery in sales has just begun and we expect strong growth momentum to continue in the medium term. We expect two-wheeler companies to continue to take benefits from cost and operational efficiency achieved in Q2 & Q3 FY21. Given a solid volume growth performance and margin expansion, companies are likely to get premium valuation over average historical valuations. We maintain a positive stance on the two-wheeler industry. We prefer Hero MotoCorp, TVS Motor and Bajaj Auto in the sector.

Key risks

Fear of second wave of COVID-19, rising commodity prices and shortage of semi-conductors are key concerns going forward.

Preferred Stocks: Hero MotoCorp, TVS Motor, Bajaj Auto.

Valuations (Sector Coverage)

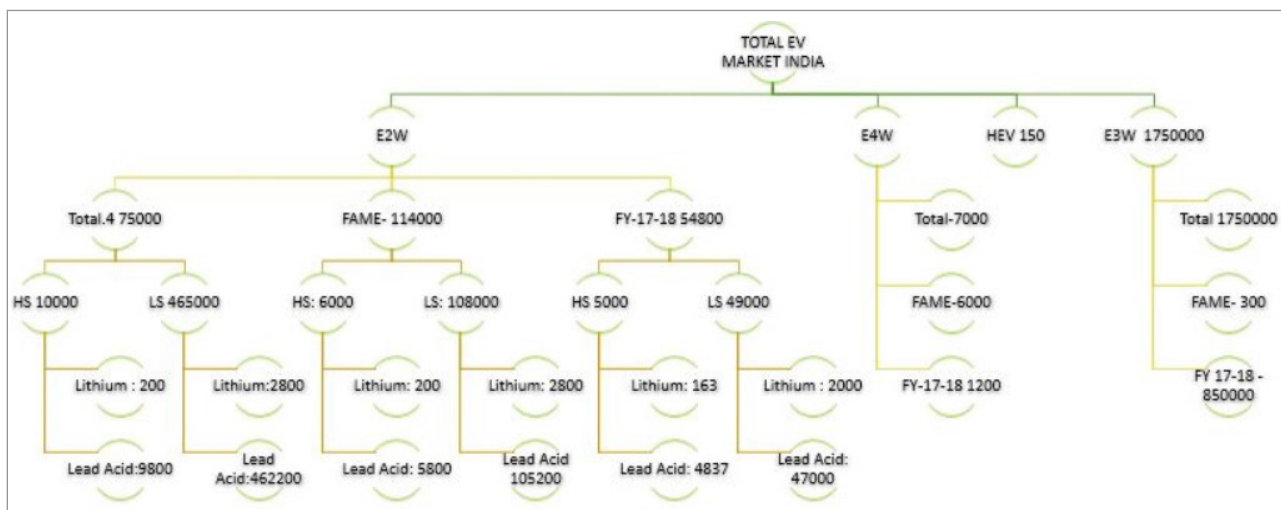
| Company | CMP | Reco | Upside/ (down-side) | PT (Rs) | EPS | | | | P/E (x) | | | |
|----------------------------|--------|----------|------------------------|---------|-------|-------|-------|-------|---------|-------|-------|-------|
| | | | | | FY20 | FY21E | FY21E | FY22E | FY20 | FY21E | FY21E | FY22E |
| Alicon Castalloy Limited # | 463 | Buy | 500 | 12.7 | (5.9) | 18.1 | 38.8 | 36.3 | NA | 25.5 | 11.9 | 21.4 |
| Amara Raja Batteries | 915 | Buy | 1,146 | 38.7 | 36.3 | 43.8 | 50.5 | 23.7 | 25.2 | 20.9 | 18.1 | 16.0 |
| Apollo Tyres | 250 | Buy | 290 | 8.3 | 11.6 | 18.3 | 24.0 | 30.0 | 21.6 | 13.6 | 10.4 | 28.8 |
| Ashok Leyland | 131 | Buy | 151 | 0.8 | (0.7) | 2.9 | 7.0 | 160.6 | NA | 44.5 | 18.7 | 18.4 |
| Bajaj Auto | 3,901 | Buy | 4,589 | 176.3 | 166.1 | 189.5 | 218.5 | 22.1 | 23.5 | 20.6 | 17.9 | 23.7 |
| Balkrishna Industries | 1,634 | Hold | 1,800 | 48.9 | 57.6 | 70.3 | 81.6 | 33.4 | 28.4 | 23.3 | 20.0 | 27.4 |
| Bosch | 15,297 | Buy | 18,156 | 441.3 | 329.4 | 482.1 | 585.7 | 34.7 | 46.4 | 31.7 | 26.1 | 16.5 |
| Exide Industries \$ | 207 | Buy | 229 | 10.0 | 8.3 | 9.7 | 10.8 | 17.3 | 20.8 | 17.8 | 19.1 | 24.3 |
| GNA Axles | 393 | Buy | 490 | 24.6 | 22.9 | 29.5 | 36.3 | 16.0 | 17.2 | 13.3 | 10.8 | 18.0 |
| Greaves Cotton | 137 | Buy | 150 | 5.4 | 2.5 | 4.8 | 6.5 | 25.5 | 55.1 | 28.7 | 21.2 | 13.2 |
| Hero Motocorp | 3,424 | Buy | 4,030 | 181.9 | 152.6 | 191.0 | 212.1 | 18.8 | 22.4 | 17.9 | 16.1 | 13.2 |
| Lumax Auto Technologies # | 148 | Buy | 150 | 7.3 | 6.3 | 9.4 | 11.5 | 20.2 | 23.5 | 15.7 | 12.8 | 29.1 |
| M&M @ \$ | 852 | Buy | 1,000 | 28.6 | 32.6 | 44.3 | 51.0 | 22.0 | 19.2 | 14.2 | 12.3 | 13.1 |
| Maruti Suzuki | 7,124 | Buy | 9,000 | 187.1 | 177.7 | 264.9 | 316.5 | 38.1 | 40.1 | 26.9 | 22.5 | 34.2 |
| Mayur Uniquoters | 418 | Buy | 500 | 17.6 | 19.6 | 24.2 | 29.4 | 23.8 | 21.3 | 17.3 | 14.2 | 32.1 |
| Schaeffler India | 5,235 | Buy | 5,900 | 117.6 | 93.1 | 136.3 | 178.8 | 44.5 | 56.2 | 38.4 | 29.3 | 19.6 |
| Sundram Fasteners # | 712 | Buy | UR | 15.5 | 10.2 | 19.0 | 27.2 | 46.0 | 69.9 | 37.4 | 26.2 | 24.8 |
| Suprajit Engineering # | 285 | Buy | 300 | 7.4 | 9.4 | 13.3 | 16.4 | 38.3 | 30.2 | 21.5 | 17.4 | 20.2 |
| Tata Motors # | 349 | Buy | 365 | (26.5) | (9.4) | 18.5 | 25.5 | NA | NA | 18.8 | 13.7 | 11.4 |
| TVS Motors \$ | 624 | Buy | 688 | 13.1 | 13.0 | 20.7 | 25.2 | 43.7 | 44.1 | 27.8 | 22.8 | 11.4 |
| GNA Axles | 258 | Positive | 28.5% | 332 | 24.6 | 16.0 | 16.0 | 22.6 | 10.5 | 16.2 | 16.2 | 11.4 |
| GNA Axles | 258 | Positive | 28.5% | 332 | 24.6 | 16.0 | 16.0 | 22.6 | 10.5 | 16.2 | 16.2 | 11.4 |

Source: Company; Sharekhan Research

@ MM & MVML; # Consolidated; \$ core business valuation; UR Under Review

Electric two-wheelers market in India

Electric two-wheelers (e-2Ws) are battery-powered vehicles. They are broadly e-2Ws can be divided into two categories – electric scooters (e-scooters) and electric motorcycles (e-motorcycles). The e-2W market can also be classified by battery capacity (48-59V, 62-72V, 73-96V and above 96V), battery type (lead acid and Li-Ion) and motor placement (hub type and chassis type). The e-2W market in India is very nascent and contribution to overall 2W sales is less than 1%. As per the SMEV (The Society of Manufacturers of Electric Vehicles), total e-2w sales in FY19 was 1,22,858 units, of which ~58% sales were made under FAME-I scheme. Also, more than 60% of the e-2W sales in the country comprise low-speed electric scooters (i.e. less than 25km/hr). The market for high speed e-2Ws is small but is growing faster.

Indian EV market


Source: SMEV; Sharekhan Research

Policy and Regulatory Landscape

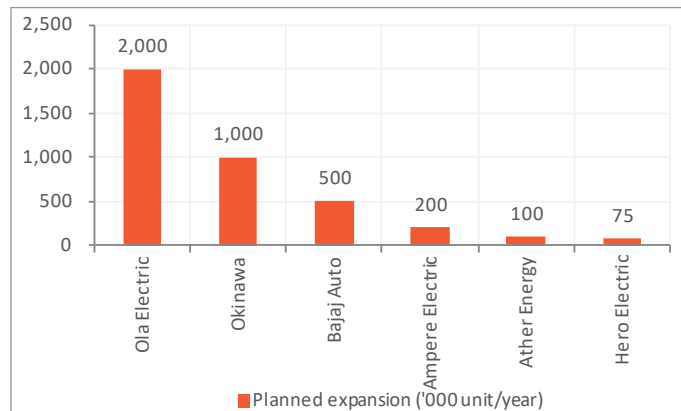
The government has recently launched a 'Go Electric' campaign to spread awareness to spread awareness on the benefits of e-mobility and EV charging infrastructure. The campaign is aimed at creating awareness at Pan-India level and is expected to boost the confidence of EV manufacturers. Also, the campaign seeks support from other stakeholders as well that includes State Governments and other central government departments. Manufacturers are expected to play key role and thus, the government assured their support. Under the campaign, the government has planned to conduct various workshops on EV solutions, roadshows with local bodies, technical talks with manufacturers and research bodies and capacity-building seminars.

Though the government have been pushing for the adoption of the EVs since 2010 post the launch of MNRE incentive scheme for EV, the success has not been encouraging. The government launched various schemes such as NEMMP 2020 in 2012, FAME policy in 2015, Second Automotive Olan 2016 to 2026 again in 2015, Niti Aayog roadmap in 2017 and the recent FAME-II scheme and 'Go Electric' campaign in 2020. However, the government's intent is well laid out through the GO Electric campaign. This push from the government is likely to focus on faster electrification in the country. Under the FAME –II EV, the government has given priority to E-2Ws, E-3Ws and e-buses through incentives and subsidies. We expect leading 2W manufacturers such as Hero MotoCorp, Bajaj Auto and TVS Motor to expedite efforts towards cleaner energy and play as catalyst for faster adoption of e-2Ws.

Competitive Landscape

The e-2W players can be broadly divided into two categories – players that manufacture slow-speed e-2Ws and new players, who focus on newer technologies and fast speed e-2Ws. The newer technology has Li-Ion battery, which has advantages of lower charging time and longer distance coverage in a single charge. As per data released by SIAM, Hero Electric leads the industry with >30% market share followed by Okinawa (20.5%), Ampere (16.6%), Ather Energy (11.2%), Revolt Intellicorp (7.7%), Bajaj Auto (4.6%), Pure EV (2.6%) and other players having a market share of below 2%. The market size is small but exciting. Bigger players such as Hero MotoCorp, Bajaj Auto and TVS Motor have started investing in the e-2W space. Bajaj Auto and TVS Motor has already launched e-scooters in 2020, while Hero MotoCorp invested in Ather Energy and holds 34.6% stake. Hero MotoCorp is working on mass e-2W model, which is slated to be launched next year. Greaves Cotton is investing in the e-2W space through its subsidiary Ampere Electric. Ola Electric has signed an MoU with the Tamil Nadu government to set up e-scooter facility with an investment of Rs. 2,400 crore, with an initial production capacity of 20 lakh electric vehicles per annum.

Capacity expansion plans of OEMs in e-2W



Source: Media; Sharekhan Research

Adoption of e-2Ws slower

Despite multiple initiatives taken by government and serious investments made by OEMs, the EV penetration in the two-wheeler markets has not been picked up as initially planned. There are few concerns that slowed down the e-2W penetrations. At present, the e-2W purchasers are mostly early adopters having decent personal disposable incomes and environment consciousness. Customers normally buy e-2W as additional vehicles. E-2W adoption by mass consumer is expected to take time till comfort of infrastructure, technology comfort and pricing between the ICE and electric 2Ws narrows. The potential customer has two main challenges while buying e-2W – the cost of e-2W vehicles, which is 50% higher than the comparable ICE technology two-wheeler and secondly, customers' anxiety over the resale value and shorter battery life. An ICE 2W runs for a longer duration and maintenance costs are lower after 4-5 years of use. In case of e-2W, the battery life is around 3-4 years and the cost of replacing battery is as high as 60-70% of the price of new e-2Ws.

Way ahead for e-2Ws

Despite concerns of slower adoption of the e-2Ws, the large two-wheeler players are taking big strides on developing technology and supportive infrastructure for electric vehicles. Hero MotoCorp owns a 34.6% stake in Ather Energy, which has around 11% market share in the e-2W market. Hero MotoCorp is developing a mass e-2W product, which is slated to be launched next year. Similarly, Bajaj Auto has launched its e-2W scooter under the iconic brand “Chetak”, which used to be a dominant brand in two-wheelers two decades back. Bajaj Auto holds a 48% stake in its technology partner KTM, which sells around 50,000 e-motorcycles globally. Also, TVS has launched its e-2Ws in 2020 and expanding its e-scooters in export markets. With Ola Electric coming to India for e-2W, we expect benefits to accrue for e-2W industry. The sourcing of Li-Ion battery also remains a key concern. The government push on adopting e-buses and passenger vehicles is likely to generate demand for higher battery usage in India and thus, would reduce the batteries prices. Also, the government has announced incentives for ACC battery manufacturers through the PLI scheme. The PLI scheme for ACC batteries will incentivize large domestic and global players in establishing a competitive technology set-up in the country. PLI scheme will benefit companies with plans of making Li-ion batteries in India, such as Exide (capacity of >1.5Gwh battery packs), Denso-Toshiba-Suzuki JV and Tata Chemicals. We expect the adoption of e-2W will gradually improve over time.

ACC Batteries industry to get benefitted through PLI scheme

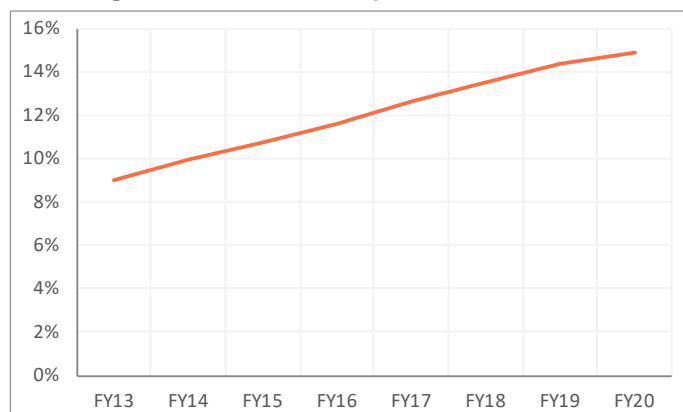
| Companies | |
|-------------------------|--|
| Exide Industries | Invested in a JV with Leclanché SA to build lithium-ion batteries and provide energy storage systems for India's EV market and grid-based applications. Exide has increased its stake to 80.15% in JV. PLI can help its expediting its Li-ion project. |
| Tata Chemicals | Tata Chemicals is running a pilot project Li-ion battery plant in Gujarat. It has invested Rs 4,000 crore to set up 10GW capacity and is in a lookout for a partner that can bring technology to move into new markets. Incentives from PLI scheme could help it in getting foreign investments. |

Source: Media; Sharekhan Research

Structural demand for 2W to drive growth ahead

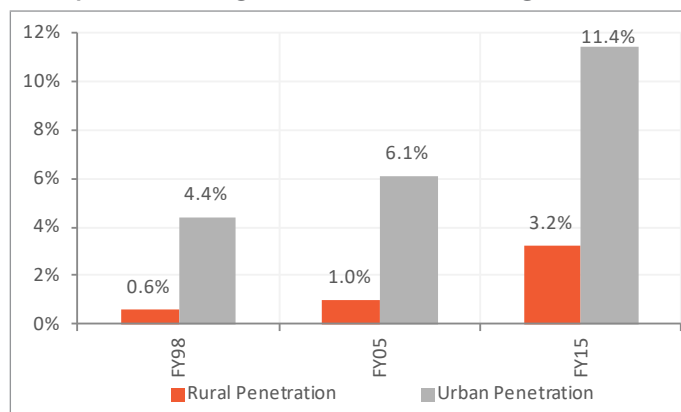
Structural demand for two-wheelers remains strong and will drive growth post normalisation of economic activities, owing to improving personal income, increasing penetration in rural economy and two-wheelers being the most preferred mode of personal transportation. We expect the two-wheeler industry to end FY2021 with a decline of 15.6% y-o-y against a decline of 14.3% y-o-y YTD FY2021, followed by a strong 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E. Incremental growth is likely to come from Economy and Executive motorcycle segments, which are slated to grow by 11% y-o-y and 10.4% y-o-y in FY2022E, respectively, driven largely by rural and tier-2 and tier-3 cities. A recovery from urban areas will also help growth.

Increasing trend for two-wheeler penetration in India



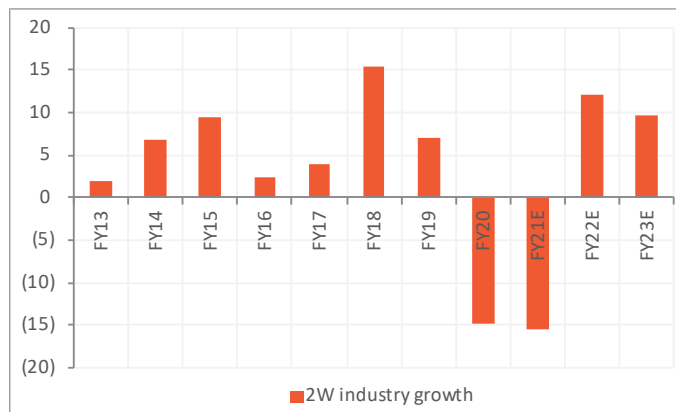
Source: MORTH; Sharekhan Research

Rural penetration key to two-wheeler demand growth



Source: Ministry of Health; Sharekhan Research

Two-wheeler industry to remain buoyant

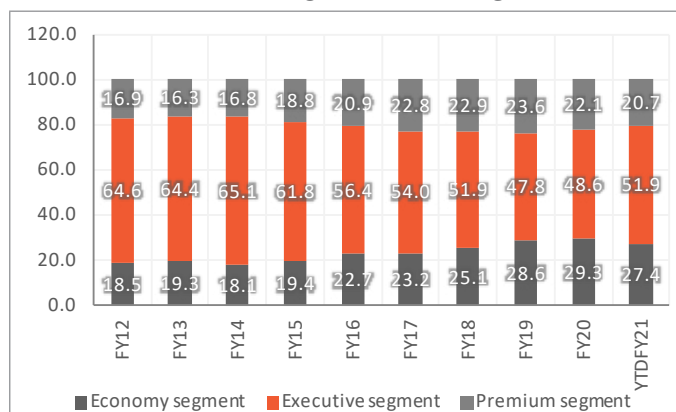


Source: SIAM; Sharekhan Research

Economy/ Executive segments remain key growth drivers

The economy and executive segments are expected to be the chief growth drivers for the sector, given that they together contribute ~80% of demand, while premium bikes are expected to grow faster due to urban recovery. Post the easing of lockdown, the share of economy and executive bikes are rising on back of higher sales in rural and semi-urban areas. Good monsoons and the favourable trends for agriculture products further helped strong growth in economy/executive segment. Also, the 75-100 cc bike segment saw strong growth led by demand for food delivery segment.

Trend reversed for Economy-Executive during COVID-19



Source: SIAM; Sharekhan Research

Demand in scooter segment to remain buoyant

The scooter segment is witnessing buoyant demand, driven by increase in female ownership and growing usage of scooters as family vehicles. The scooter segment is led by HSI with 55.6%, followed by TVS Motor (19.4%), Suzuki (11.7%) and Hero MotoCorp (7.1%). The electric scooter is an emerging sector driven by the government's focus on electric vehicles. However, during the COVID-19, the electric vehicle sales slowed down due to supply issues.

Two wheelers likely to be preferred mode of transport amid COVID-19

We remain positive on the two-wheeler industry, driven by strong demand, which we believe is likely to stay, despite the prevalence of COVID-19. Personal transportation is considered as a safer travel option amid COVID-19 and two-wheeler becomes an affordable choice for general public. Channel checks suggest strong underlying demand from rural areas and tier-2 and tier-3 cities, which we believe will be the growth path ahead. As the economy is moving towards normalisation, we expect the growth recovery from urban areas as well and add further pace to overall demand. We expect the two-wheeler industry to outpace the other vehicle industry, given affordability and personal safety amid COVID-19.

Outlook and Valuation

Outlook

Two-wheelers will continue to dominate Indian automobile industry's growth, given their affordability; but, within two-wheelers, we expect the economy and executive segments to drive growth. We also expect premium bikes to outpace the industry's growth, while scooters would grow in line with the industry, driven by new launches and an expected recovery in urban areas. Export markets for Indian two-wheelers remain less affected by COVID-19, resulting in strong growth. Among the top ten export destinations for two-wheelers, only two countries, viz Colombia and Mexico severely impacted by COVID-19 pandemic. We expect the two-wheeler segment to grow by 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E, driven by solid demand recovery, low base, affordability, and a recovery in key export markets.

In the two-wheeler space, we expect Hero MotoCorp to continue its dominance in the economy and executive motorcycles segment, which contributes bulk of the motorcycle market's size. Hero MotoCorp enjoys extensive distribution and dealer network in the country and have a strong presence in tier 2&3 cities and rural areas from where we expect large part of incremental demand for two-wheelers. Bajaj Auto is expected to show growth in the premium bike segment and export markets, given its strong brands in high-growth segments. The product mix should drive better margin performance for Bajaj. TVS Motor is expected to perform well because of its new launches and export sales.

Valuation

Despite a run-up in stock prices of two-wheeler companies over the past two quarters, stocks are available below historical multiple averages. The recovery in sales has just begun and we expect strong growth momentum to continue in the medium term. We expect two-wheeler companies to continue to take benefits from costs and operational efficiencies achieved in Q2 & Q3 FY21. Given a solid volume growth performance and margin expansion, companies are likely to get premium valuation over average historical valuations. We stay positive on the two-wheeler industry. We prefer Hero MotoCorp, TVS Motor and Bajaj Auto in the sector.

Peer Comparison

| Particulars | P/E (x) | | | EV/EBIDTA (x) | | | RoCE (%) | | |
|---------------|---------|-------|-------|---------------|-------|-------|----------|-------|-------|
| | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Hero MotoCorp | 22.4 | 17.9 | 16.1 | 14.6 | 11.3 | 9.5 | 26.1 | 30.7 | 27.1 |
| TVS Motor | 48.0 | 30.2 | 24.8 | 21.5 | 15.6 | 13.2 | 16.4 | 22.1 | 23.5 |
| Bajaj Auto | 23.5 | 20.6 | 17.9 | 17.7 | 14.6 | 12.2 | 27.7 | 28.4 | 28.8 |

Source: Company, Sharekhan estimates

Key Risks

A second wave of COVID-19 can lead to slowdown in economic activities and, thus, can affect the company's earnings. Industry growth can be impacted if there happens to supply issues and cannot be resolved sooner.



3R MATRIX

| | + | = | - |
|----------------------|---|---|---|
| Right Sector (RS) | ✓ | ✗ | ✗ |
| Right Quality (RQ) | ✓ | ✗ | ✗ |
| Right Valuation (RV) | ✓ | ✗ | ✗ |

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

| | Old | | New |
|----|-----|---|-----|
| RS | ✓ | ↔ | ✓ |
| RQ | ✓ | ↔ | ✓ |
| RV | ✓ | ↔ | ✓ |

Reco/View

| | Change |
|-------------------------|--------|
| Reco: Buy | ↔ |
| CMP: Rs. 3,901 | |
| Price Target: Rs. 4,589 | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

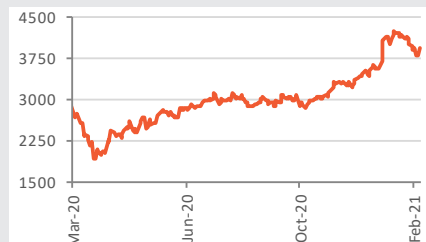
Company details

| | |
|-------------------------------|-------------------|
| Market cap: | Rs. 1,12,872 cr |
| 52-week high/low: | Rs. 4,361 / 1,793 |
| NSE volume: (No of shares) | 9.8 lakh |
| BSE code: | 532977 |
| NSE code: | BAJAJ-AUTO |
| Free float: (No of shares) | 13.4 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 53.7 |
| FII | 13.1 |
| DII | 12.0 |
| Others | 21.2 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|-------|------|------|------|
| Absolute | -1.5 | 24.5 | 28.1 | 34.4 |
| Relative to Sensex | -10.1 | 10.5 | -0.6 | 7.9 |

Sharekhan Research, Bloomberg

Automobiles

Sharekhan code: BAJAJ-AUTO

Company Update

Summary

- We interacted with the management of Bajaj Auto Limited (BAL) to discuss its plans for electric two-wheelers (e-2Ws) and readiness to benefit from increasing e-2W penetration in the medium to long term. The company is well positioned both in terms of capacity and capability to roll out faster e-2Ws, if the adoption of electric vehicles succeeds at a faster rate.
- BAL is expected to benefit from growth in the premium bikes segment, which is recovering, aided by premiumization trend and new launches. Moreover, we expect BAL to gain market share in exports, driven by its brand equity and enhanced distribution network.
- Improvement in operating profit margin (OPM) witnessed in Q2 & Q3 of FY21 is likely to stay, driven by cost and operational efficiency.
- The stock is trading at P/E multiple of 17.9x and EV/EBITDA multiple of 12.2x its FY2023E estimates and is at below its long-term average multiples. We retain our Buy rating on the stock.

We interacted with the management of Bajaj Auto Limited (BAL) to discuss its plans for electric two-wheelers (e-2Ws) and its readiness to benefit from increasing e-2W penetration in the medium to long term. Bajaj Auto has launched its e-2W scooter with its iconic brand name "Chetak" in January 2020 in two cities, Pune and Bangalore. It plans to launch it in 30 cities over the next 18-24 months. After the phase-I of its expansion plan, BAL will roll a full-scale nationwide rollout, thanks to its significant increase in production capacity after opening its second facility in Chakan. Also, BAL holds 48% stake of its technology partner KTM, which sells around 50,000 e-motorcycles globally. The company is well positioned both in terms of capacity and capability to roll out faster e-2Ws, if the adoption of electric vehicles succeeds at faster rate. We expect Bajaj Auto Limited (BAL) to benefit from the expected recovery from urban markets, where we believe BAL will be a major beneficiary in the two-wheeler (2W) space, given its dominant position in the premium bike segment. Demand for three-wheelers (3Ws) is also expected to improve going forward, as COVID-19 vaccination rolls throughout the country. This will help BAL to improve its margin aided by richer product mix and operating efficiencies. BAL will also benefit from new launches in the premium segment, which it has lined up in the premium segment over the next 12-18 months. The management continues to focus on new launches and expects to launch at least one model (either new or upgraded model) every quarter. BAL has positioned itself strongly in export markets with its focus on Nigeria, Bangladesh, Philippines, and Colombia, which accounts for ~50% of its 2W export revenue. In 3W exports, BAL has a strong presence in Nigeria, Egypt, Cambodia, and Iraq. Products are well diversified and have favourable sales mix in under-penetrated markets such as Africa. BAL has improved its brand equity in these markets, which will help to improve its market share. During Q3FY2021, more than 85% of its export revenue was generated from geographies where BAL is either No. 1 or No. 2 player. Export growth is organic and will continue to be a long-term driver for BAL. The company aims to outpace the industry in international operations, driven by increased distribution reach. 3W volumes are also improving on m-o-m basis, as the economy is moving towards normalcy. Domestic 3W sales are expected to improve with the opening of schools, colleges, other educational institutions, and corporates. Moreover, BAL is aiming to protect its margins as rising input costs are offset by price hikes, better product mix, and cost-control measures. We expect EBITDA margin to remain above 18% in the medium term. The company is debt free and generates strong cash flows, which are enough to expand capacity through internal accruals. The company has a strong long-term revenue visibility, given its leadership position in the premium bikes segment and key export destinations. We expect BAL's earnings to grow by 14.1% in FY2022E and 15.3% in FY2023E, driven by a mix of volume growth and margin expansion. We remain positive on BAL and retain our Buy rating on the stock.

Our Call

Valuation - Maintain Buy with a PT of Rs. 4,589: BAL is witnessing strong recovery in domestic 2Ws and exports demand, while there is slow recovery in 3W demand. The outlook remains positive with strong recovery expected from FY2022, driven by normalisation of economic activities. OPM is likely to expand because of richer product mix, operating leverage, and cost-control measures. We have increased our earnings estimates to factor in improved business outlook. We have maintained our PT to Rs. 4,589 on 21x its FY2023E estimated earnings. The stock is trading at P/E multiple of 17.9x and EV/EBITDA multiple of 12.2x its FY2023E estimates. We retain our Buy rating on the stock.

Key Risks

BAL can lose its market share, if EVs in the domestic 3W market rise faster than we expect. Moreover, BAL has a significant exposure to export markets. Any slowdown in export markets and unfavourable forex fluctuations can affect the company's profits adversely.

Valuation (Standalone)

| Particulars | FY19 | FY20 | FY21E | FY22E | Rs cr FY23E |
|---------------|--------|--------|--------|--------|----------------|
| Net Sales | 30,358 | 29,919 | 28,370 | 32,779 | 37,419 |
| Growth (%) | 20.4 | -1.4 | -5.2 | 15.5 | 14.2 |
| EBIDTA | 5,192 | 5,096 | 5,205 | 6,104 | 6,998 |
| OPM (%) | 17.1 | 17.0 | 18.3 | 18.6 | 18.7 |
| Recurring PAT | 4,333 | 5,100 | 4,802 | 5,481 | 6,320 |
| Growth (%) | 5.7 | 17.7 | -5.8 | 14.1 | 15.3 |
| EPS (Rs) | 149.8 | 176.3 | 166.1 | 189.5 | 218.5 |
| PE (x) | 26.0 | 22.1 | 23.5 | 20.6 | 17.9 |
| P/BV (x) | 5.2 | 5.7 | 5.1 | 4.5 | 3.9 |
| EV/EBIDTA (x) | 18.1 | 19.3 | 17.7 | 14.6 | 12.2 |
| RoNW (%) | 19.9 | 25.6 | 21.6 | 21.7 | 22.0 |
| RoCE (%) | 28.3 | 32.1 | 27.7 | 28.4 | 28.8 |

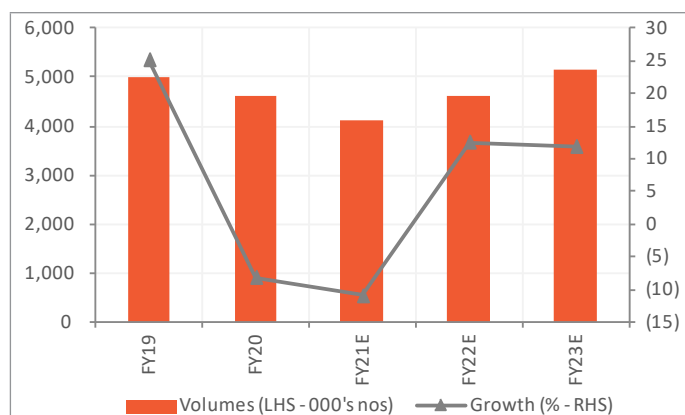
Source: Company; Sharekhan estimates

We interacted with the management of Bajaj Auto Limited (BAL) to discuss its plans for electric two-wheelers (e-2Ws) and readiness to benefit from increasing e-2W penetration in the medium to long term. The key highlights of the interactions are as follows,

- ♦ The e-2W industry is at nascent stage in India with penetration less than 1% of domestic 2W market. The adoption of e-2W would require major push from the government – not just incentivising electric vehicles but also discouraging ICE vehicles.
- ♦ Despite multiple initiatives taken by the Government and serious investments made by OEMs, the EV penetration in the two-wheeler markets has not been picked up as initially planned. There are few concerns that slowed down the e-2W penetrations.
- ♦ At present, the e-2W purchasers are mostly early adopters having decent personal disposable incomes and environment consciousness. Customers normally buy e-2W as additional vehicles. E-2W adoption by mass consumer is expected to take time till get comfort of infrastructure, technology comfort and pricing between the ICE and electric 2Ws narrows.
- ♦ The potential customer has two main challenges while buying e-2W – the cost of e-2W vehicles, which is 50% higher than the comparable ICE technology two-wheeler and secondly, customers' anxiety over the resale value and shorter battery life. An ICE 2W runs for a longer duration and maintenance costs are lower after 4-5 years of use. In case of e-2W, the battery life is around 3-4 years and the cost of replacing battery is as high as 60-70% of the price of new e-2Ws.
- ♦ Bajaj Auto has launched its e-2W scooter with its iconic brand name "Chetak" in January 2020 in two cities, Pune and Bangalore. The product has received a strong response from customers. There is pending registration for more than 50,000 e- scooters. The company has been facing supply issues due to the COVID-19 pandemic earlier and now on back of shortage of semi-conductors.
- ♦ The 'Chetak' is slated to be launched in additional 30 cities over the next 18-24 months. After the phase-I of its expansion plan, BAL will roll a full-scale nationwide rollout, thanks to its significant increase in production capacity after opening of second facility in Chakan.
- ♦ BAL holds 48% stake of its technology partner KTM, which sells around 50,000 e-motorcycles globally. The company is well positioned both in terms of capacity and capability to roll out faster e-2Ws, if the adoption of electric vehicles succeeds at faster rate.

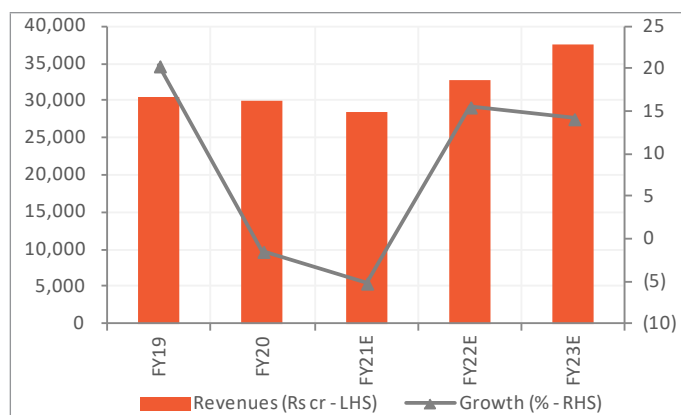
Financials in charts

Volumes Trends



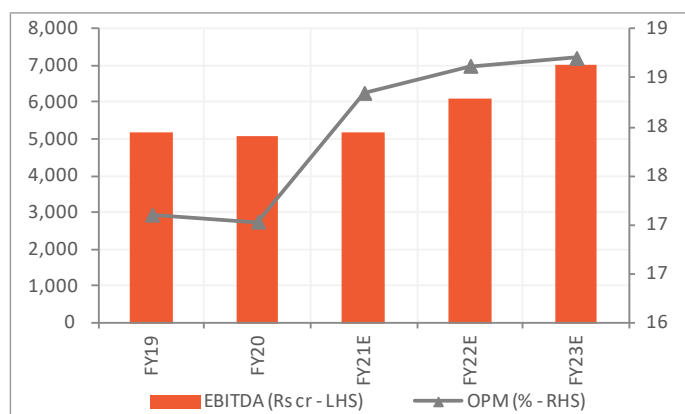
Source: Company, Sharekhan Research

Revenue and Growth trend



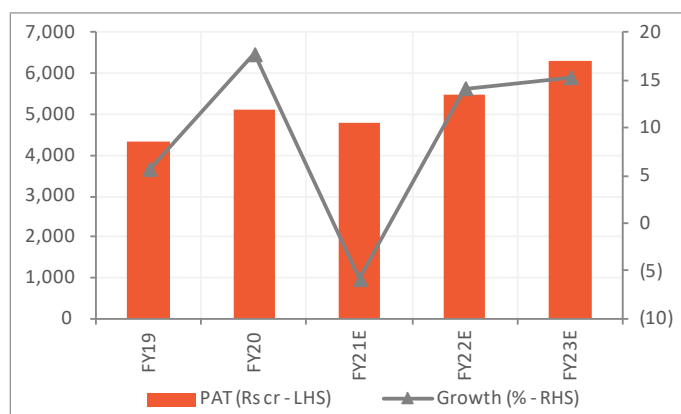
Source: Company, Sharekhan Research

EBITDA and OPM Trend



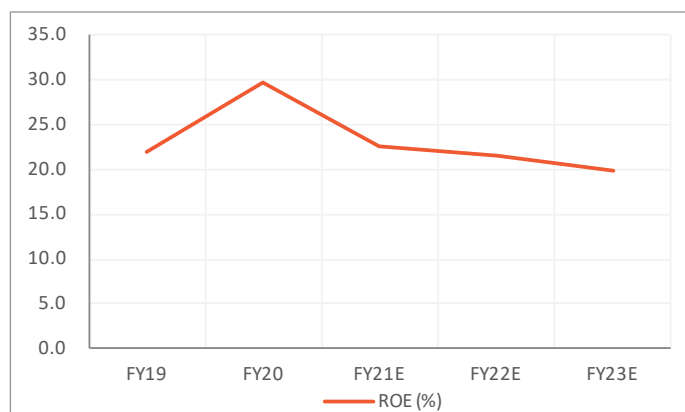
Source: Company, Sharekhan Research

PAT and Growth Trends



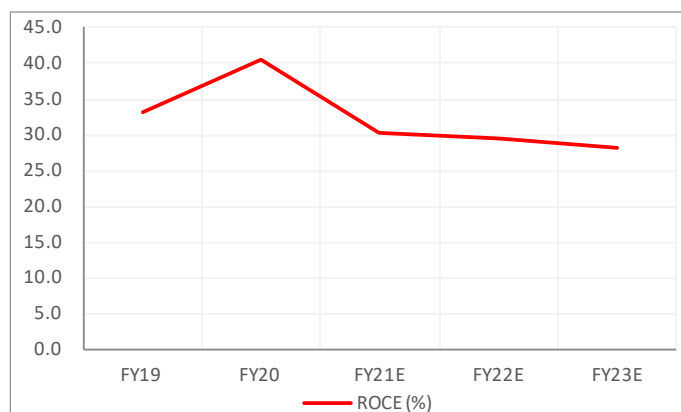
Source: Company, Sharekhan Research

ROE Trend



Source: Company, Sharekhan Research

ROCE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Demand picking up in domestic as well as export markets

2W demand has been improving on a m-o-m basis and the trend has continued through the festive season in October-November 2020. We expect this growth momentum to continue in Q4FY2021, driven by strong rural sentiments, supported by higher kharif sowing. The government's reform measures coupled with the increased preference for personal transport are expected to improve volumes. We expect strong recovery from FY2022, driven by normalisation of economic activity and pent-up demand. Export markets have witnessed notable recovery in volume sales offtake across regional markets - ASEAN, South Asia, Middle East, and Africa. Indian OEMs are positive on recovery and expect these markets to improve.

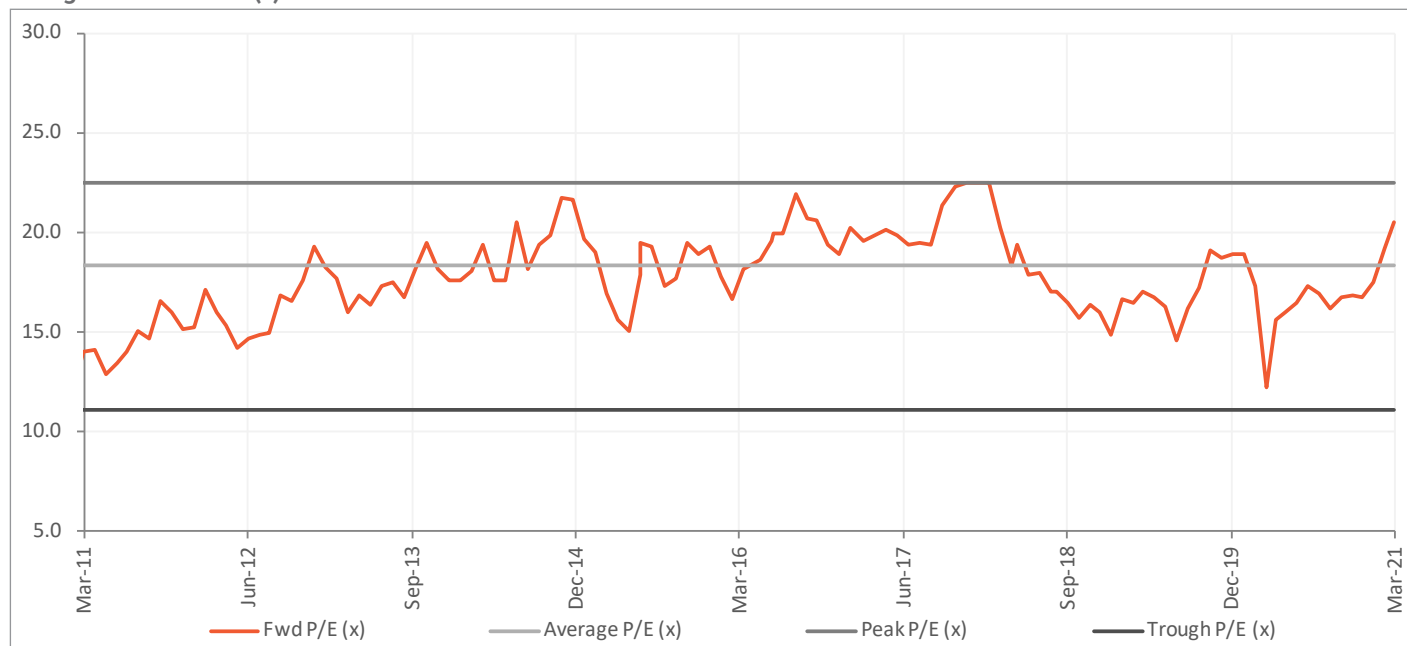
■ Company outlook - Strong earnings growth

BAL is India's second largest motorcycle player with a market share of about 20%. The company is the market leader in the premium motorcycle segment (125cc-200cc) with a market share of 41%. With new launches, BAL aims to increase its market share further and is targeting market share of around 25% over the next few years. With network expansion, BAL aims to retain its leadership position in motorcycle exports. BAL has a strong balance sheet with zero debt. The company has cash and cash equivalents worth Rs. 16,240 crore with strong return ratios. BAL has healthy dividend pay-out ratio of 40%-45%. The company is thus uniquely positioned to benefit from domestic 2W demand and export market, driven by its brand equity and value proposition. We expect BAL's earnings to grow by 14.1% in FY2022E and 15.3% in FY2023E, driven by a mix of volume growth and margin expansion.

■ Valuation - Maintain Buy with a PT of Rs. 4,589:

BAL is witnessing strong recovery in domestic 2Ws and exports demand, while there is a slow recovery in 3W demand. The outlook remains positive with strong recovery expected from FY2022, driven by the normalisation of economic activities. OPM would expand because of richer product mix, operating leverage, and cost-control measures. We have increased our earnings estimates to factor in improved business outlook. We have maintained our PT to Rs. 4,589 on 21x its FY2023E estimated earnings. The stock is trading at P/E multiple of 17.9x and EV/EBITDA multiple of 12.2x its FY2023E estimates. We retain our Buy rating on the stock.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

BAL is one of the leading automobile manufacturers in India and is a leader in the premium motorcycle segment with a lion's share. The company also makes 3W and is a leader in the 3W segment. Motorcycles constitute around 85% of the overall volumes, while 3W contribute around 15% share.

Investment theme

BAL is the second largest motorcycle manufacturer in India with a market share of about 20%. Over the years, BAL has created a strong brand not only domestically but also in export markets. BAL is the leader in the premium motorcycle segment having a market share of 41%. Apart from premium motorcycles, BAL is also the leader in the 3W segment, commanding a market share of about 57%. Motorcycles constitute about 85% of overall volumes, while 3W contribute 15% share. BAL is well positioned in the domestic as well as in global markets to deliver sustained growth in the long term. The company is a leader in the premium segment bikes such as Pulsar, Avenger, KTM, Dominar, and Husqvarna. Exports currently constitute about 45% of overall volumes, with Africa, Southeast Asia, and Latin America amongst the key markets. During Q3FY2021, more than 85% of export revenue was generated from geographies where BAL is either No. 1 or No. 2 player. Export growth is organic and will continue to be a long-term driver for BAL. We remain positive on the company's growth prospects going forward.

Key Risks

- ♦ BAL can lose its market share if EVs in the domestic 3W market rise faster than we expect.
- ♦ BAL has significant exposure to export markets. Any slowdown in export markets and unfavourable forex fluctuations can affect the company's profits adversely.

Additional Data

Key management personnel

| | |
|---------------|--------------------|
| Rahul Bajaj | Chairman Executive |
| Rajiv Bajaj | MD & CEO |
| Rakesh Sharma | Executive Director |
| Soumen Ray | CFO |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|----------------------------------|-------------|
| 1 | Bajaj Holdings & Investment Ltd. | 33.43 |
| 2 | Jamnalal Sons Pvt. Ltd. | 9.08 |
| 3 | Life Insurance Corp of India | 4.76 |
| 4 | Jaya Hind Industries Ltd. | 3.35 |
| 5 | Maharashtra Scooters Ltd. | 2.34 |
| 6 | Bajaj Sevashram Pvt. Ltd. | 1.54 |
| 7 | SBI Funds Management | 1.36 |
| 8 | Bachhraj & Co Pvt. Ltd. | 1.26 |
| 9 | Norges Bank | 1.09 |
| 10 | Vanguard Group Inc. | 1.08 |

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.



3R MATRIX

| | + | = | - |
|----------------------|---|---|---|
| Right Sector (RS) | ✓ | ✗ | ✗ |
| Right Quality (RQ) | ✓ | ✗ | ✗ |
| Right Valuation (RV) | ✓ | ✗ | ✗ |

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

| | Old | | New |
|----|-----|---|-----|
| RS | ✓ | ↔ | ✓ |
| RQ | ✓ | ↔ | ✓ |
| RV | ✓ | ↔ | ✓ |

| Reco/View | Change |
|-------------------------|--------|
| Reco: Buy | ↔ |
| CMP: Rs. 3,424 | |
| Price Target: Rs. 4,030 | ↔ |

↑ Upgrade
↔ Maintain
↓ Downgrade

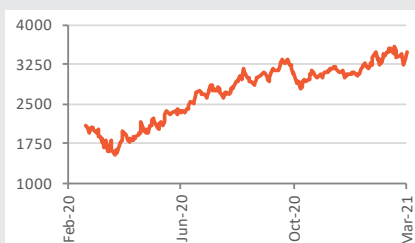
Company details

| | |
|-------------------------------|-------------------|
| Market cap: | Rs. 68,400 cr |
| 52-week high/low: | Rs. 3,629 / 1,475 |
| NSE volume: (No of shares) | 15.6 lakh |
| BSE code: | 500182 |
| NSE code: | HEROMOTOCO |
| Free float: (No of shares) | 13.0 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 34.8 |
| FII | 35.9 |
| DII | 20.0 |
| Others | 9.4 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|------|------|-------|------|
| Absolute | 6.7 | 11.9 | 9.9 | 64.6 |
| Relative to Sensex | -1.9 | -2.0 | -18.8 | 38.0 |

Sharekhan Research, Bloomberg

Hero MotoCorp Limited

A powered-up growth plan

Automobiles

Sharekhan code: HEROMOTOCO

Company Update

Summary

- We interacted with the management of Hero MotoCorp (Hero) to discuss its plans for electric two-wheelers (e-2Ws) and readiness to benefit from increasing e-2W penetration in the medium to long term.
- We believe structural growth traction in the two-wheeler (2W) industry remains intact and Hero continues to benefit from premiumisation of its products, its stronghold in the economy and executive motorcycle segments, and aggressive products offerings in the premium bike and scooters segments.
- Hero will continue to benefit from its brand equity, due to value-for-money products, extensive service centres, low maintenance cost and higher resale value.
- The stock is valued at P/E multiple of 16.1x and EV/EBITDA multiple of 9.5x its FY2023E estimates. We retain a Buy rating on the stock.

We interacted with the management of Hero MotoCorp (Hero) to discuss its plans for electric two-wheelers (e-2Ws) and readiness to benefit from increasing e-2W penetration in the medium to long term. The company has invested in Ather Energy, a start-up company, taking a 34.6% stake. Hero is also planning to launch its own developed mass scale e-2W in FY2022. The company is open to invest into new ventures, where Hero finds a technological edge. Hero is well positioned to acquire or partner with new ventures in the EV space to scale businesses through its network and improve quality through its capable R&D division. The company's R&D centre in Germany will focus on primarily two products – building premium bike portfolio and developing EV products. We believe the structural growth drivers for the two-wheelers (2W) industry remains intact. Hero is expected to benefit from premiumisation of products, its stronghold in the economy and executive motorcycle segments, and aggressive products offerings in premium bike and scooters segments. Hero is a market leader in the Indian two-wheeler industry, commanding a ~38.5% share. The company commands ~65% market share in the combined economy and executive motorcycle segment, which together makes up 80% of the motorcycle market size in India. Hero has strong reach in semi-urban and rural areas, aided by its largest distribution network in the 2W industry. We expect Hero to be the beneficiary of rural demand and the increased need for personal mobility in a post COVID-19 scenario. Hero's brand equity is because of value-for-money products, extensive service centres, low maintenance cost and higher resale value. The company has renewed focus on gaining market share in the premium bike segment and increase exports capability. Its partnership with Ather Energy and Harley Davidson will help Hero increase its presence in new technology and premium segment bikes. We expect a strong recovery in FY2022, driven by normalisation of economic activities, operating leverage, price hikes and cost-savings under the company's leap programme, which would drive up margins. We expect Hero to reach its historical margin range of 14%-16%. Hence, we retain a Buy rating on the stock.

Our Call

Valuation - Maintain Buy with a PT of Rs. 4,030: A positive outlook given by the management underpins our positive outlook for the two-wheeler industry. Structural demand for two-wheelers remains strong and will drive growth post normalisation of economic activities, owing to improving personal income, increasing penetration in the rural economy, and two-wheelers being the most preferred mode of personal transportation. We expect the 2W industry to end FY2021 with a decline of 15.6% y-o-y against a decline of 16.3% y-o-y YTD FY2021, followed by strong 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E. Incremental growth is likely to come from economy and executive motorcycle segments, which are slated to grow by 11% y-o-y and 10.4% y-o-y in FY2022E, respectively, driven largely by rural and tier-2 and tier-3 cities. We expect Hero to be the greatest beneficiary in the sector given its leadership and largest distribution network. The stock is valued at P/E multiple of 16.1x and EV/EBITDA multiple of 9.5x its FY2023E estimates. We retain a Buy rating on the stock with PT of Rs. 4,030.

Key Risks

Success of rival products in the entry and executive bike segments can impact Hero's market share in the segments. Moreover, if the second wave of COVID-19 intensifies, it can impact the company's sales.

Valuation (Standalone)

| | Rs cr | | | | |
|---------------|--------|--------|--------|--------|--------|
| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
| Net Sales | 33,651 | 28,836 | 31,287 | 36,293 | 39,922 |
| Growth (%) | 4.4 | -14.3 | 8.5 | 16.0 | 10.0 |
| EBIDTA | 4,930 | 3,958 | 4,135 | 5,266 | 5,875 |
| OPM (%) | 14.7 | 13.7 | 13.2 | 14.5 | 14.7 |
| PAT | 3,385 | 3,633 | 3,048 | 3,814 | 4,236 |
| Growth (%) | -8.5 | 7.3 | -16.1 | 25.1 | 11.1 |
| FD EPS (Rs) | 169.5 | 181.9 | 152.6 | 191.0 | 212.1 |
| P/E (x) | 20.2 | 18.8 | 22.4 | 17.9 | 16.1 |
| P/B (x) | 5.3 | 4.8 | 4.5 | 4.2 | 3.3 |
| EV/EBIDTA (x) | 12.6 | 15.1 | 14.6 | 11.3 | 9.5 |
| RoE (%) | 26.3 | 25.7 | 20.3 | 23.6 | 20.7 |
| RoCE (%) | 37.2 | 26.5 | 26.1 | 30.7 | 27.1 |

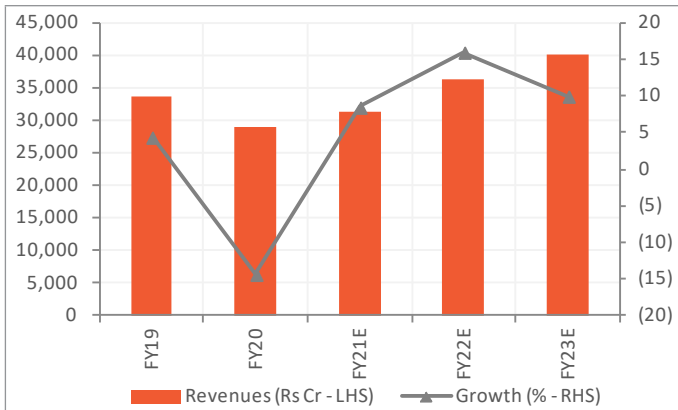
Source: Company; Sharekhan estimates

Key highlights of the interaction with the management were as follows

- ♦ The e-scooter segment can be further categorised in two sub-segments – slow speed (i.e. <25 km/hr) technology and high speed (> 25km/hr) technology. The new entrants in e-scooter segment are generally manufacturing faster models that can run a greater distance in a single charge.
- ♦ Customers can be classified as innovators or early adopters. These customers are not price conscious but are adventurers and environment-conscious.
- ♦ The mass customers have not yet adopted to e-2Ws largely due to relatively higher price of e-2Ws as against comparable model in the ICE technology.
- ♦ The government has been continuously offering incentives and subsidies through schemes such as FAME-I and FAME-II. Despite promoting EVs, the FAME-I and FAME-II remain underutilised due to slower adoption of the e-2Ws. Further, the government has not been able to give attractive incentives to corporate.
- ♦ However, HERO has invested in Ather Energy, a start-up company, taking a 34.6% stake. Ather Energy has a market share of 11.6% in the e-2W segment. The company has not ruled out the possibility of taking majority control and greater synergies with Ather. Established in 2013, Ather Energy has been manufacturing and selling electric scooters in Bengaluru and has recently entered the Chennai market.
- ♦ Besides its investment in Ather Energy, HERO is working to develop its own product lines in e-2Ws. Hero is also planning to launch its own mass-market product (e-2W) in FY2022.
- ♦ The company is open to invest in new ventures, where Hero finds a technological edge. Hero is well positioned to acquire or partner with new ventures in the EV space to scale businesses through its network and improve quality through its capable R&D division. The company's R&D centre in Germany will focus on primarily two products – a premium bike portfolio and developing EV products.
- ♦ HERO is well-positioned to benefit from faster adoption in the e-2W segment.

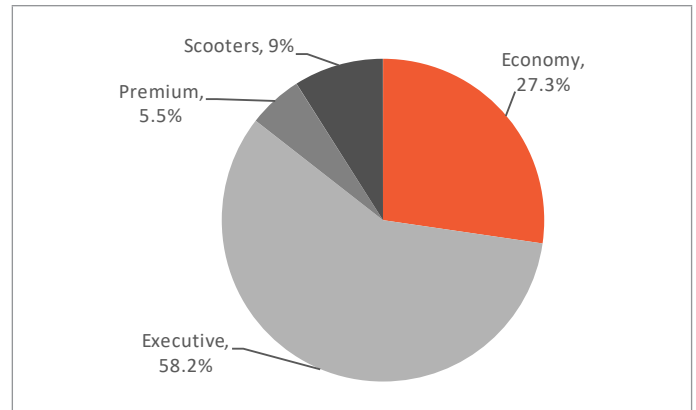
Financials in charts

Revenue and Growth Trend



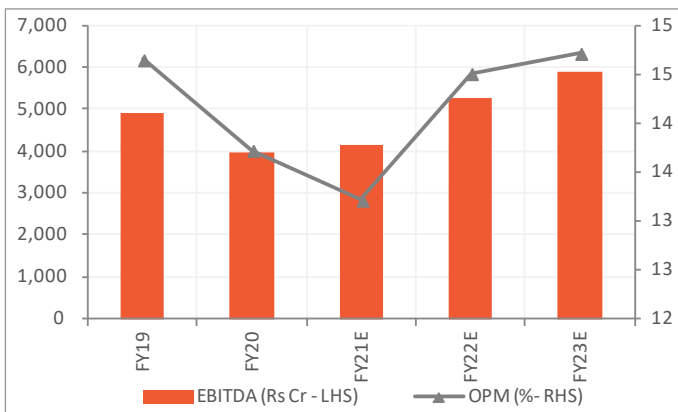
Source: Company, Sharekhan Research

Product Mix (%)



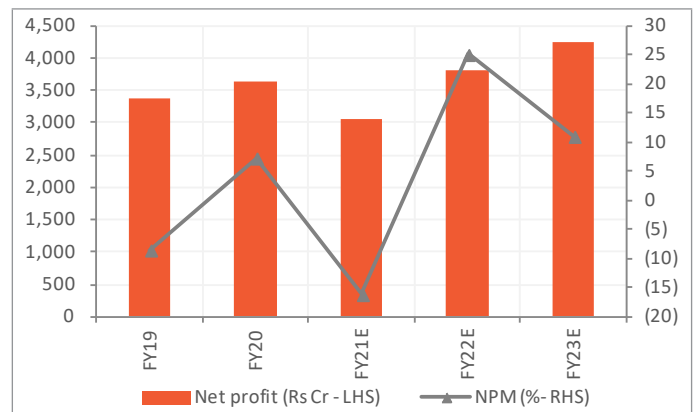
Source: Company, Sharekhan Research

EBITDA and OPM Trend



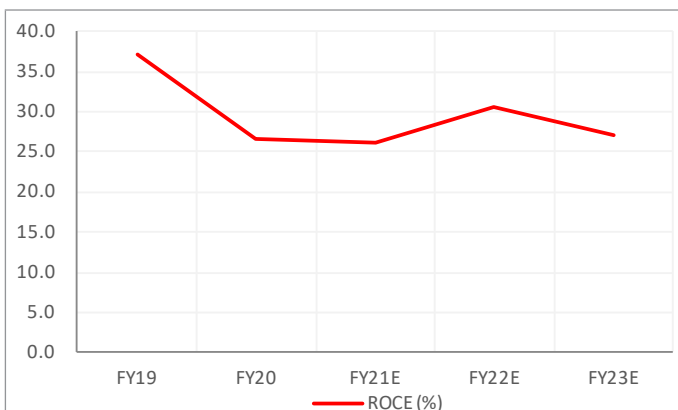
Source: Company, Sharekhan Research

Net profit and NPM Trend



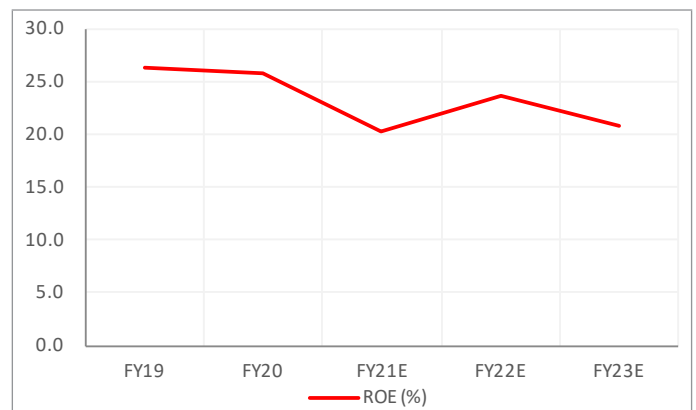
Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Demand picking up in domestic and export markets

Two-wheeler demand has been improving on m-o-m basis and the trend has continued after festive seasons in October- November. We expect growth momentum to continue in H2FY2021E, driven by strong rural sentiments, supported by higher kharif sowing. The government's reform measures coupled with increased preference for personal transport are expected to improve volumes. We expect a strong recovery from FY2022, driven by normalisation of economic activity and pent-up demand (the industry has been in the downcycle for the past 7-8 quarters). Export markets have witnessed a notable recovery in volume sales offtake across regional markets - ASEAN, South Asia, Middle East, and Africa. Indian OEMs are positive on recovery and expect these markets to improve.

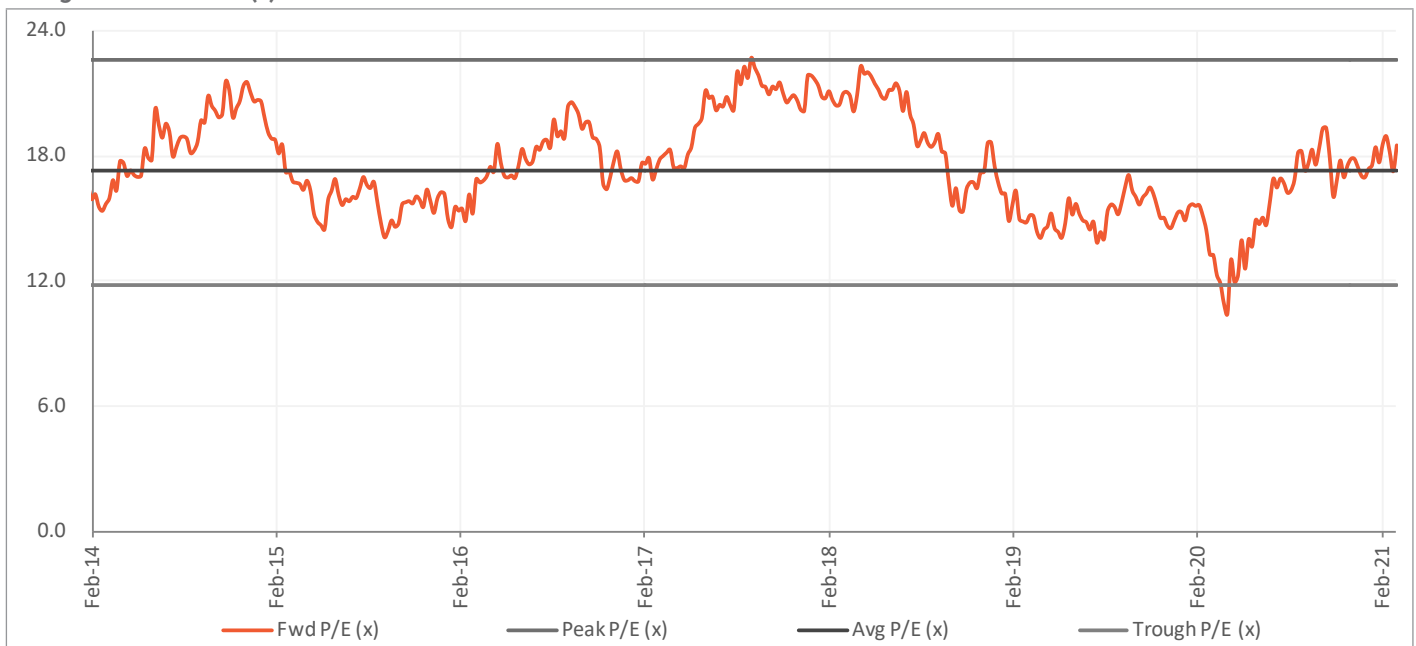
■ Company outlook - Beneficiary of 2W demand

Hero is the market leader commanding about 38.5% market share in the 2W space. Moreover, Hero has the highest rural exposure with rural sales contributing about half of volumes. With strong farm sentiments on account of good monsoon and higher kharif sowing, we expect Hero to retain its leadership position. Hero has a strong balance sheet with zero debt. The company has cash and cash equivalents worth Rs. 6,400 crore with strong return ratios. Hero has a healthy dividend pay-out ratio of 55%-65%.

■ Valuation - Maintain Buy with a revised PT of Rs. 4,030

A positive outlook given by the management underpins our positive outlook for the two-wheeler industry. Structural demand for two-wheelers remains strong and will drive growth post normalisation of economic activities, owing to improving personal income, increasing penetration in the rural economy, and two-wheelers being the most preferred mode of personal transportation. We expect the 2W industry to end FY2021 with a decline of 15.6% y-o-y against a decline of 16.3% y-o-y YTD FY2021, followed by strong 12.2% y-o-y growth in FY2022E and 9.5% y-o-y growth in FY2023E. Incremental growth is likely to come from economy and executive motorcycle segments, which are slated to grow by 11% y-o-y and 10.4% y-o-y in FY2022E, respectively, driven largely by rural and tier-2 and tier-3 cities. We expect Hero to be the greatest beneficiary in the sector given its leadership and largest distribution network. The stock is valued at P/E multiple of 16.1x and EV/EBITDA multiple of 9.5x its FY2023E estimates. We retain a Buy rating on the stock with PT of Rs. 4,030.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Hero is the market leader in the 2W industry with a market share of 38.5%. Hero is present in both the motorcycles and scooter segments, with a market share of about 51.9% and 12.4%, respectively. Motorcycles form the major chunk of revenue, contributing about 90% to volumes, while scooters contribute about 10% of volumes. Hero is a domestically focused company deriving about 97% of its volumes from the Indian market. Entry-level motorcycles (75 cc to 110 cc) form a major chunk of about 72.5% of overall volumes.

Investment theme

Hero is a market leader in the Indian 2W industry, commanding a ~38.5% share. The company commands ~65% market share in the economy and executive motorcycle segment, which together makes up 80% of motorcycle market size in India. Hero has strong penetration in semi-urban and rural areas, aided by its largest distribution network in the 2W industry. We expect Hero to be the beneficiary of rural demand and increased personal mobility. The company is also making in-roads in the premium bike segment in partnership with Harley Davidson. Operating leverage, price hikes, and cost saving under the leap programme would result in margin improvement. We expect Hero to reach its historical margin range of 14%-16%. Hence, we retain our Buy rating on the stock.

Key Risks

- Success of rival products in the entry and executive bike segments can impact Hero's market share in the segments.
- Hero is expanding its product portfolio aggressively in the premium bikes segment. Unsuccessful launches in the premium segment can restrain its growth path.

Additional Data

Key management personnel

| | |
|------------------------|--|
| Dr. Pawan Munjal | Chairman, Managing Director and CEO |
| Mr. Vikram S. Kasbekar | Executive Director and Chief Technical Officer |
| Mr. Niranjan Gupta | Chief Financial Officer |
| Ms. Neerja Sharma | Company Secretary and Chief Compliance Officer |

Source: Company Website

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|-------------------------------------|-------------|
| 1 | Bahadur Chand Investments Pvt. Ltd. | 20.00% |
| 2 | MUNJAL PAWAN | 13.98% |
| 3 | Life Insurance Corp of India | 5.24% |
| 4 | Standard Life Aberdeen PLC | 3.37% |
| 5 | SBI Funds Management Pvt. Ltd. | 2.99% |
| 6 | Franklin Resources Inc | 2.27% |
| 7 | BlackRock Inc. | 2.24% |
| 8 | Lazard Ltd. | 1.86% |
| 9 | Vanguard Group Inc. | 1.75% |
| 10 | ICICI Prudential Life Insurance Co. | 1.40% |

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Understanding the Sharekhan 3R Matrix

| Right Sector | |
|-----------------|--|
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| Right Quality | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet |
| Right Valuation | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

Source: Sharekhan Research

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