Indiabulls

HERO HONDA MOTORS LIMITED
RESEARCH

EQUITY RESEARCH November 15, 2007

RESULTS REVIEW

Share Data

Market Cap	Rs. 136.4 bn
Price	Rs. 682.80
BSE Sensex	19,784.89
Reuters	HROH.BO
Bloomberg	HH.IN
Avg. Volume (52 Week)	0.1 mn
52-Week High/Low	Rs. 808.80/565
Shares Outstanding	199.7 mn

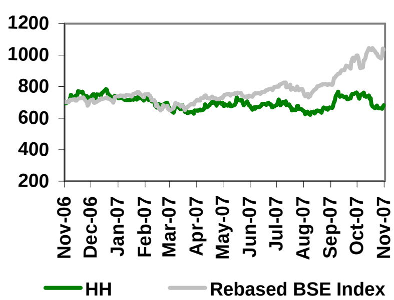
Valuation Ratios (Consolidated)

Year to 31 March	2008E	2009E
EPS (Rs.)	44.1	50.0
+/- (%)	1.3%	13.5%
PER (x)	15.5x	13.6x
EV/ Sales (x)	1.3x	1.1x
EV/ EBITDA (x)	10.8x	9.5x

Shareholding Pattern (%)

Promoters	55
FIIs	28
Institutions	8
Public & Others	10

Relative Performance



Hero Honda Motors Limited — Hold

Strong show despite slowdown in the auto industry

Hero Honda Motors Limited, the world's largest two-wheeler manufacturer, reiterated its undisputed leadership by reporting better-than-industry performance during Q2'08. Despite the fact that the auto industry is currently showing signs of slowdown owing to higher interest rates and swelling down-payments, Hero Honda witnessed expansion in volume growth. The Company has been able to withstand the slowdown better than its immediate rival Bajaj Auto, primarily due to focus on overall cost management internally over the last two quarters coupled with stabilising prices of aluminium and nickel.

The Company's net sales went up 5.5% yoy to Rs. 23.5 bn backed by an increase in price realisation coupled with marginal improvement in volumes. Owing to its strong market reputation, Hero Honda sold 756,633 units of two-wheelers during the quarter, an increase of 4,696 units over the corresponding period last year. EBITDA for Q2'08 improved marginally by 2.8% yoy, however, sequentially the growth was substantial at 10.6% to Rs. 2.9 bn. Though net profit dipped by 5.4% yoy to Rs. 2 bn, it improved by 7.6% on a qoq basis.

With a view to capture the growing two-wheeler market and enhance its market share, Hero Honda has recently launched 'Hunk' in the premium segment bikes. Moreover, the ongoing festive season would aid the Company to achieve the projected volume growth in the H2'08.

Taking into account the strong performance of Hero Honda with respect to the double digit dip in the industry growth rate and the expected expansion in volumes in the upcoming quarters, we maintain our Hold rating on the stock.

Key Figures (Consolidated)

Quarterly Data	Q2'07	Q1'08	Q2'08	YoY%	QoQ%	H1'07	H1'08	YoY%
(Figures in Rs. mn, except per share data)								
Volumes (mn)	0.75	0.80	0.76	0.6%	(5.8%)	1.58	1.56	(1.6%)
Net Sales	22,300	24,480	23,521	5.5%	(3.9%)	45,943	48,001	4.5%
EBITDA	2,835	2,635	2,915	2.8%	10.6%	6,025	5,549	(7.9%)
Adjusted Net Profit	2,160	1,898	2,043	(5.4%)	7.6%	4,537	3,942	(13.1%)
Margins(%)								
EBITDA	12.7%	10.8%	12.4%			13.1%	11.6%	
NPM	9.7%	7.8%	8.7%			9.9%	8.2%	
Per Share Data (Rs.)								
Adjusted EPS	10.8	9.5	10.2	(5.4%)	7.6%	22.7	19.7	(13.1%)

Result Highlights

125-250 cc segment volumes rose by a whooping 183%

During the second quarter ended Sep'07, net sales grew by 5.5% yoy to Rs. 23.5 bn. This can be attributed to a 4.8% yoy increase in price realisation (up from Rs. 29,655 per unit in Q2'07 to Rs. 31,086 per unit in Q2'08) and marginal improvement in volumes (up by 4,696 units to 756,633 units in Q2'08). The higher price realisation was a result of improvement in product mix as the Company has already launched five new models in H1'08, in contrast to a total of eight vehicles launched in FY07.

Margins continue to remain under pressure as a result of rising input costs

Though EBITDA increased by a mere 2.8% yoy to Rs. 2.9 bn, yet, on a sequential basis the improvement was substantial at 10.6%. However, EBITDA margin dipped by 32 bps yoy to 12.4% due to a significant increase in raw material cost as a percentage of net sales (up by 53 bps yoy). This increase in raw material cost can be attributed to higher prices of tyres and steel. The decline in EBITDA margin was partially offset by a reduction in other expenditure, especially advertising expenses, as a percentage of sales (down by 11 bps yoy). As there were no new launches during the quarter, advertisement expenses were significantly reduced. The cost management efforts and the fall in the prices of aluminium and nickel also provided some respite to EBITDA margin.

During Q2'08, net profit went down by 5.4% yoy to Rs. 2 bn while net profit margin eroded by 100 bps yoy to 8.7%. The decline can be attributed to competitive pressures, rising costs and a 34% yoy decline in other income. However, on a sequential basis Hero Honda recorded a growth of 7.6%.

Key Events

"Hunk" adds to the Company's premium segment share

To enhance the product mix, Hero Honda Motors has added a fourth product "Hunk" in the premium segment after Karizma, Achiever and CBZ Xtreme. Although, the premium segment is ruled by Bajaj Auto's Pulsar, with a 60% market share, the Company plans to launch more vehicles in this segment as it is a high margin business. With the launch of Bajaj's 125 cc XCD and

TVS's 125 cc Flame, we expect Hero Honda to launch more models in the executive segment as well.

Prospects

Daimler eyeing to tie-up with Hero Honda for CV joint venture

Hero Honda is negotiating with German auto major Daimler, for an alliance in the commercial vehicle segment. The two companies are expected to form a JV, with both sides taking equity stake and setting up a separate manufacturing facility for the project.

Key Risks

- Volatility in interest rates and rising costs
- New launches (XCD and Flame) pose a risk to Hero Honda's market share
- Delay in the production at the Haridwar Plant

Outlook

Higher discount offerings and intense competition to affect the margins

Despite a subdued growth of 5.5% yoy in net sales during Q2'08, we remain positive on the Company's long term growth. Even though the auto industry reported a double digit dip in the growth rate resulting from a rise in interest rates and heavy down-payments, Hero Honda continues to outperform its immediate peers by reporting a growth in its sales volume as well as a higher price realisation. Moreover, with the ongoing festive season, higher discount offerings and stabilising interest rates the two-wheeler volumes are likely to get a boost. To meet the increasing demand, the Company has started producing at full capacity. We anticipate volumes to pick up from the third quarter of FY08E onwards as five new models have already been launched this year, and more are expected to be launched. However, a concern that needs more attention is the reduction in shelf life of two wheelers and phasing out of products in the extremely competitive two-wheeler market.

We estimate the net sales to grow at a CAGR of 11.3% and net profit at a CAGR of 7.2% for FY07-FY09E. At the CMP of Rs.682.80 the stock is trading at a P/E of 15.5x FY08E and 13.6x FY09E earnings estimates. Based on our valuation and estimates, we maintain our Hold rating on the stock.

Key Figures (Consolidated)

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs. mn, except per share data)						(FY07-09E)
Net Sales	74,217	87,140	99,000	109,076	122,711	11.3%
EBITDA	11,677	13,689	11,891	12,737	14,452	10.2%
Adjusted Net Profit	8,126	9,743	8,689	8,804	9,990	7.2%
Margins(%)						
EBITDA	15.7%	15.7%	12.0%	11.7%	11.8%	
NPM	10.9%	11.2%	8.8%	8.1%	8.1%	
Per Share Data (Rs.)						
Adjusted EPS	40.7	48.8	43.5	44.1	50.0	7.2%
PER (x)	13.3x	18.2x	15.7x	15.5x	13.6x	

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