

## HERO HONDA MOTORS

HOLD  
CMP Rs1,789  
TP Rs1,806

21 July 2011

### Volume Gain; Margin Pain

Hero Honda (HH) Q1FY12 operating results were below expectation as adjusted margin at 11.3% was 70bps below our estimate. However, increase in other income and a lower tax rate helped the company post a net profit of Rs5.58bn, ahead of our estimate of Rs5.4bn. The contraction in margins was attributable to a sharp increase in raw material cost.

**Volumes continue to remain strong:** HH had a remarkable quarter in terms of volumes with a 23.9% YoY growth to 1.5mn units. The company clocked a volume of 0.5mn units in each of the three months. Domestic motorcycle sales were up 23.1% to 1.4mn units. Scooter segment continues to generate traction with a growth of 35.8% YoY to 98k units. With emphasis on exports post Honda exit, overseas volumes were up 26.9% to 38k units.

**Margins disappoint:** Although HH took a price hike at the start of the quarter, average realisations were up only by Rs90 to Rs37.2k/unit. However, raw material cost per vehicle jumped by Rs750 (2.8%) QoQ to Rs27.8k/unit. Raw material cost as a percentage of sales at 74.7% was highest ever reported by the company. Adjusted for royalty payments, margins contracted 275bps YoY (84bps QoQ) to 11.3% and were significantly below our estimate of 12%.

**Other income, lower tax rate boosts profits:** With yields on treasury investments hardening, other income jumped 65% YoY to Rs884mn. Tax rate during the quarter at 16.7% was 330bps below our estimate. Contributed by these two factors, net profit at Rs5.58bn was 3% higher than our estimate inspite of a below par operating performance.

**Outlook:** On the backdrop of the volume performance of Q1FY12, we continue to maintain a volume estimate of 6.1mn units in FY12 as against the management guidance of 6mn units. Although margin during the quarter was disappointing, we expect an improved performance in the coming quarter aided by price hikes and some softening in commodity prices. Hence we maintain our earnings estimate for FY12 and FY13 at Rs111 and Rs129 respectively.

### VALUATIONS AND RECOMMENDATION

The stock is currently trading at 13.9x its FY13E earnings. We maintain a 'HOLD' rating on the stock with a target price of Rs1,806 discounting FY13E earnings 14x.

KEY FINANCIALS						Rs mn
	FY09	FY10	FY11P	FY12E	FY13E	
Net Sales	123,191	157,582	192,450	227,088	259,395	
YoY Gr.(%)	19.2	27.9	22.1	18.0	14.2	
EBITDA	17,668	27,705	26,170	35,056	40,544	
EBITDA margin (%)	14.3	17.5	13.5	15.3	15.5	
Adjusted Net Profit	12,818	22,318	19,838	22,162	25,762	
YoY Gr.(%)	32.6	74.1	(11.1)	11.7	16.2	
KEY RATIOS						
Dil. EPS (Rs)	64.2	111.8	99.3	111.0	129.0	
ROCE (%)	49.0	73.4	59.7	60.2	66.7	
RoE (%)	37.8	61.4	61.9	64.0	56.3	
PER (x)	27.9	16.0	18.0	16.1	13.9	
EV/Net sales (x)	2.6	1.9	1.7	1.4	1.2	
EV/EBDITA (x)	18.3	10.8	12.3	9.4	7.8	

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### QUARTERLY SNAPSHOT (Rs mn)

	Quarter Ended		
	Dec-10	Mar-11	Jun-11
Net Sales	51,617	53,909	56,833
YoY Gr. (%)	34.9	30.8	32.3
EBITDA	5,766	6,528	6,407
EBITDA Mar %	11.2	12.1	11.3
Adj. Net Profit	4,849	5,016	5,579
YoY Gr. (%)	(9.5)	(16.2)	13.5

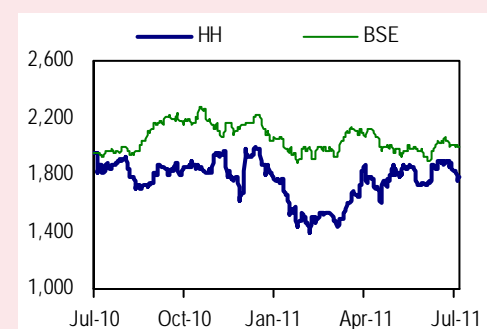
### STOCK DATA

Market Cap	Rs357.2bn
Book Value per share	Rs147.2
Eq Shares O/S (F.V. Rs2)	200mn
Free Float	47.8%
Avg Traded Value (6 mnths)	Rs0.96bn
52 week High/Low	Rs2060/1378
Bloomberg Code	HH IN
Reuters Code	HROH.BO

### PERFORMANCE (%)

	1M	3M	12M
Absolute	3.1	0.2	(8.0)
Relative	(2.2)	6.1	(10.5)

### RELATIVE PERFORMANCE



## Q1FY12 Performance and Concall Highlights

### Strong volume growth

- HH volumes during the quarter were up 23.9% to 1.5mn units. In the domestic motorcycle segment, wherein HH is the market leader, volumes were up 23.1% as against the industry growth of 19%. Consequently, HH marketshare expanded 260bps YoY to 56.5%.
- The scooter segment outperformed motorcycles with a volumes growth of 35.8%. Marketshare in the scooter segment expanded 200bps YoY to 18.3%. HH is the third largest player in this segment, close on the heels of TVS Motor.
- The inventory levels in the system continue to remain low at 15 days of sales. As on June'11 end, total inventory including in transit was 250k units.
- Post separation from Honda, Japan the company has increased focus on the export markets. Exports during the quarter were up 26.9% YoY to 38k units.

### Capacity expansion:

- The company currently has a capacity of 6.15mn units spread across three plants in North India. It will be expanding capacity to 6.5mn units by the year end through marginal increase at current locations and de-bottlenecking.
- HH is likely to make announcement regarding its greenfield facility shortly and this facility with a capacity of 0.75mn units will cost ~Rs5bn. Overall capex for FY12 is pegged at Rs9bn.

### Outlook

- Management expects 2-wheelers industry to grow at 15% during FY12. HH is expected to achieve a volume of 6mn units during FY12.
- Management expects 'Other expenses' to increase in the coming quarters due to re-branding cost and additional advertising expense. Company has guided for advertising expenses to remain in the range of 2-2.1% of net sales. Additionally an expense Rs1bn is expected to be incurred towards re-branding costs.
- The company has taken a price hike of Rs500-750 in the month of Jun'11. Management indicated pressure on margins to ease due to the price hike taken and some softening in commodity prices.
- Other income during the quarter was higher due to increased yields. However, post payment of interim dividend, treasury income is expected to reduce from current levels. Cash and cash equivalents at the end of FY11 stood at Rs40bn. Tax rate is expected to continue at current levels.

**Variance to PINC Estimate**

(Rs mn)	Actual	Estimate	Var (%)	Comments
Net Sales	56,833	57,410	(1.0)	Average realisations marginally lower than expected
EBITDA*	6,407	6,876	(6.8)	
EBITDA Margin (%)	11.3	12.0	(70)bps	Sharp increase in raw material cost led to lower margins
Adjusted PAT	5,579	5,413	3.1	Higher other income and lower tax rate boost for net profits

**Financial Table**

Rs. mn	Jun-11	Jun-10	YoY (%)	Mar-11	QoQ (%)	FY11	FY10	YoY (%)
<b>Net Sales</b>	<b>56,833</b>	<b>42,966</b>	<b>32.3</b>	<b>53,909</b>	<b>5.4</b>	<b>194,012</b>	<b>158,312</b>	<b>22.5</b>
<b>EBITDA*</b>	<b>6,407</b>	<b>6,025</b>	<b>6.3</b>	<b>6,528</b>	<b>(1.9)</b>	<b>24,399</b>	<b>27,670</b>	<b>(11.8)</b>
<i>EBITDA Margins %</i>	<i>11.3</i>	<i>14.0</i>	<i>(280)bps</i>	<i>12.1</i>	<i>(80)bps</i>	<i>12.6</i>	<i>17.5</i>	<i>(490)bps</i>
Other Income	884	534	65.5	743	18.9	2,681	2,356	13.8
Interest	(32)	(27)	19.9	81	(139.4)	(19)	(206)	(91.0)
Depreciation*	627	483	29.8	603	4.0	2,253	1,915	17.7
PBT	6,696	6,103	9.7	6,588	1.6	24,846	28,317	(12.3)
Tax	1,117	1,187	(5.9)	1,572	(28.9)	5,008	5,999	(16.5)
% PBT	16.7	19.4	(280)bps	23.9	(720)bps	20.2	21.2	(100)bps
<b>PAT</b>	<b>5,579</b>	<b>4,917</b>	<b>13.5</b>	<b>5,016</b>	<b>11.2</b>	<b>19,838</b>	<b>22,318</b>	<b>(11.1)</b>
Extraordinary Item	-	-	-	-	-	(559)	-	-
<b>Reported PAT</b>	<b>5,579</b>	<b>4,917</b>	<b>13.5</b>	<b>5,016</b>	<b>11.2</b>	<b>19,279</b>	<b>22,318</b>	<b>(13.6)</b>
<b>Adjusted EPS (Rs)</b>	<b>27.9</b>	<b>24.6</b>	<b>13.5</b>	<b>25.1</b>	<b>11.2</b>	<b>99.3</b>	<b>111.8</b>	<b>(11.1)</b>

\* Adjusted for the change in accounting policy for royalty

**Vehicle sales**

(units)	Jun-11	Jun-10	YoY (%)	Mar-11	QoQ (%)	FY11	FY10	YoY (%)
<b>Total 2-Wheelers</b>	<b>1,529,577</b>	<b>1,234,039</b>	<b>23.9</b>	<b>1,454,431</b>	<b>5.2</b>	<b>5,402,444</b>	<b>4,600,130</b>	<b>17.4</b>
Domestic	1,491,162	1,203,777	23.9	1,424,767	4.7	5,269,381	4,502,431	17.0
Exports	38,415	30,262	26.9	29,664	29.5	133,063	97,699	36.2
<b>Motorcycles</b>	<b>1,423,793</b>	<b>1,158,366</b>	<b>22.9</b>	<b>1,345,192</b>	<b>5.8</b>	<b>5,040,971</b>	<b>4,385,858</b>	<b>14.9</b>
Domestic	1,393,370	1,131,744	23.1	1,322,082	5.4	4,926,390	4,293,991	14.7
Exports	30,423	26,622	14.3	23,110	31.6	114,581	91,867	24.7
<b>Scooters</b>	<b>105,784</b>	<b>75,673</b>	<b>39.8</b>	<b>109,239</b>	<b>-3.2</b>	<b>361,473</b>	<b>214,272</b>	<b>68.7</b>
Domestic	97,792	72,033	35.8	102,685	-4.8	342,991	208,440	64.6
Exports	7,992	3,640	119.6	6,554	21.9	18,482	5,832	216.9

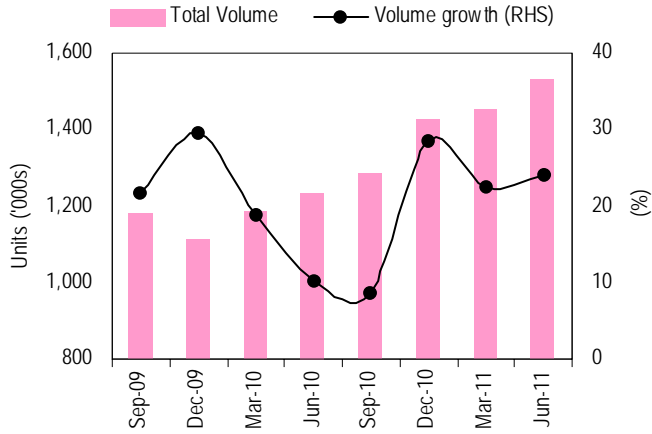
**(%) of Sales**

(%)	Jun-11	Jun-10	YOY (bps)	Mar-11	QoQ (bps)	FY11	FY10	YOY (bps)
Material Cost	74.7	71.2	350	72.8	180	72.7	67.8	490
Staff Cost	2.9	3.4	(50)	3.1	(20)	3.2	3.5	(30)
Other Expenses	8.0	11.4	(340)	8.6	(60)	10.6	11.2	(60)
<b>EBITDA Margins</b>	<b>11.3</b>	<b>14.0</b>	<b>(280)</b>	<b>12.1</b>	<b>(80)</b>	<b>12.6</b>	<b>17.5</b>	<b>(490)</b>

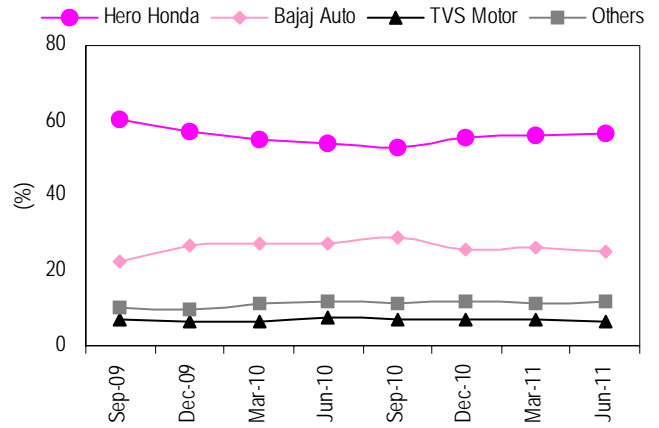
**Per Vehicle**

(Rs)	Jun-11	Jun-10	YoY (%)	Mar-11	QoQ (%)	FY11	FY10	YoY (%)
Realisations	37,156	34,817	6.7	37,066	0.2	35,912	34,415	4.4
Material cost	27,751	24,791	11.9	26,999	2.8	26,120	23,339	11.9
Staff cost	1,076	1,175	(8.5)	1,155	(6.9)	1,146	1,218	(5.9)
Other Expenses	2,983	3,968	(24.8)	3,205	(6.9)	3,802	3,843	(1.0)
<b>EBITDA</b>	<b>4,188</b>	<b>4,883</b>	<b>(14.2)</b>	<b>4,489</b>	<b>(6.7)</b>	<b>4,516</b>	<b>6,015</b>	<b>(24.9)</b>

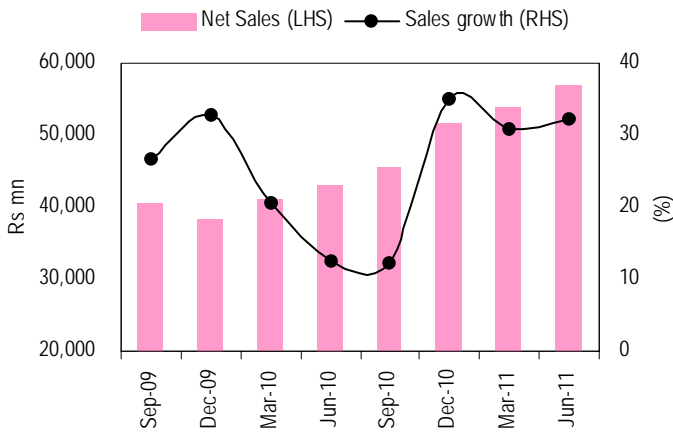
Sales Volume Trend



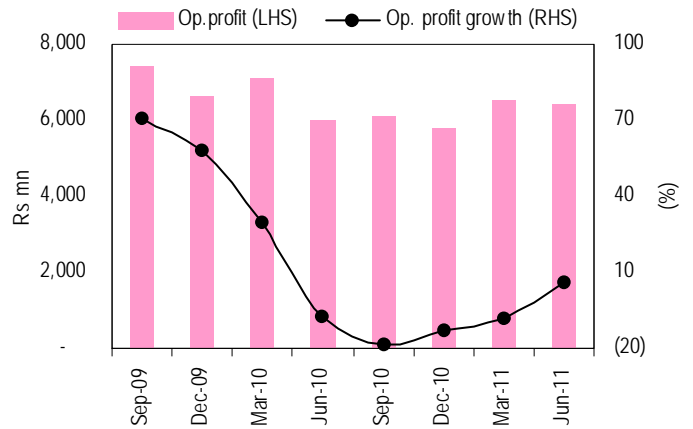
Domestic Motorcycle Marketshare



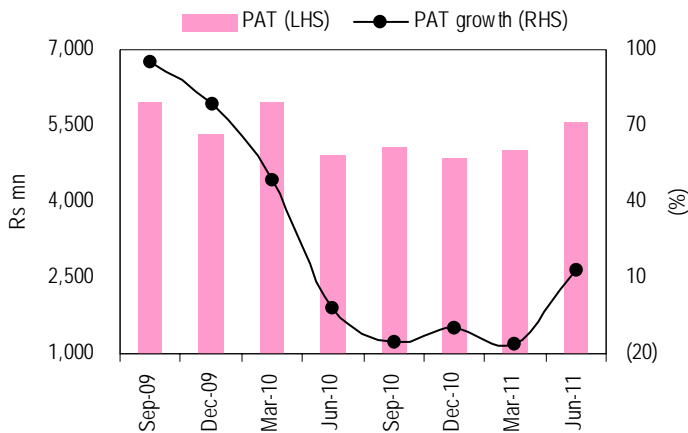
Net Sales



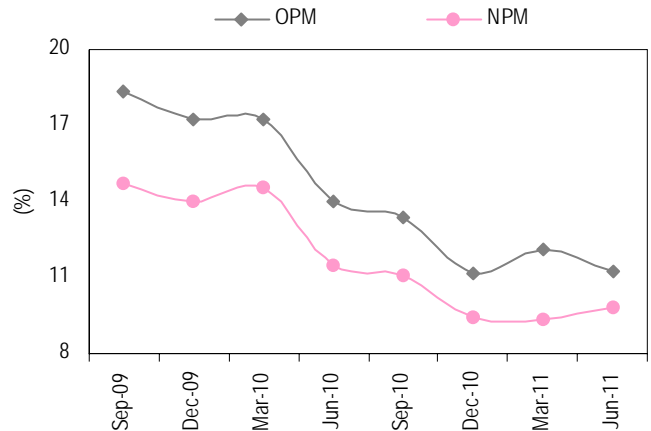
Operating Profits



Net Profits



Profitability Trend



Year Ended March (Figures in Rs mn)

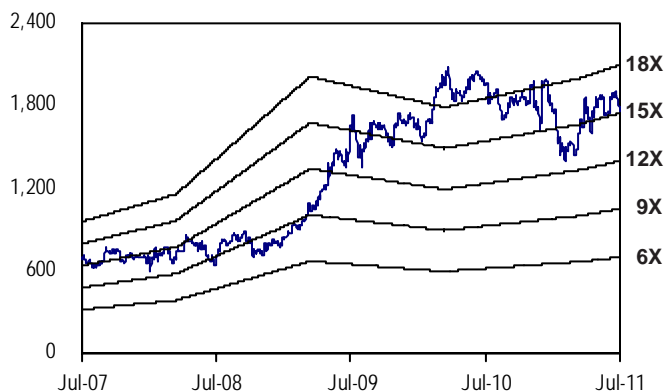
Income Statement	FY09	FY10	FY11P	FY12E	FY13E
Net Sales	123,191	157,582	192,450	227,088	259,395
Growth (%)	19.2	27.9	22.1	18.0	14.2
Operating profit	17,037	26,682	24,609	33,473	38,860
Other operating income	631	1,023	1,561	1,584	1,684
EBITDA	17,668	27,705	26,170	35,056	40,544
Growth (%)	27.4	56.8	(5.5)	34.0	15.7
Depreciation	(1,807)	(1,915)	(4,024)	(9,781)	(10,238)
Other income	1,978	2,548	2,875	2,241	2,742
EBIT	17,840	28,338	25,021	27,517	33,048
Interest paid	(25)	(21)	(175)	(20)	(20)
PBT (before E/o items)	17,815	28,317	24,846	27,497	33,028
Tax provision	(4,997)	(5,999)	(5,008)	(5,334)	(7,266)
E/o Income / (loss)	-	-	(559)	-	-
Net profit	12,818	22,318	19,279	22,162	25,762
Adjusted net profit	12,818	22,318	19,838	22,162	25,762
Growth (%)	32.6	74.1	(11.1)	11.7	16.2
Diluted EPS (Rs)	64.2	111.8	99.3	111.0	129.0
Diluted EPS Growth (%)	32.6	74.1	(11.1)	11.7	16.2

Cash Flow Statement	FY09	FY10	FY11P	FY12E	FY13E
Pre-tax profit	17,815	28,317	24,287	27,497	33,028
Depreciation	1,600	1,496	4,024	9,781	10,238
Total tax paid	(4,866)	(5,622)	(4,331)	(5,182)	(7,116)
Chg in working capital	2,225	4,975	9,663	(4,952)	(7,531)
Other operating activities	-	-	-	-	-
Cash flow from oper. (a)	16,774	29,166	33,643	27,144	28,619
Capital expenditure	(2,895)	(1,623)	(29,009)	(10,259)	(3,740)
Chg in investments	(263)	-	-	-	-
Other investing activities	-	-	-	-	-
Cash flow from inv. (b)	(3,158)	(1,623)	(29,009)	(10,259)	(3,740)
Free cash flow (a+b)	13,616	27,543	4,635	16,885	24,879
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	(535)	(125)	14,251	(12,963)	(1,921)
Chg in Minorities int.	-	-	-	-	-
Dividend (incl. tax)	(4,439)	(4,973)	(25,376)	(24,532)	(11,682)
Other financing activities	-	-	-	-	-
Cash flow from fin. (c)	(4,974)	(5,097)	(11,124)	(37,495)	(13,603)
Net chg in cash (a+b+c)	8,642	22,446	(6,490)	(20,611)	11,276

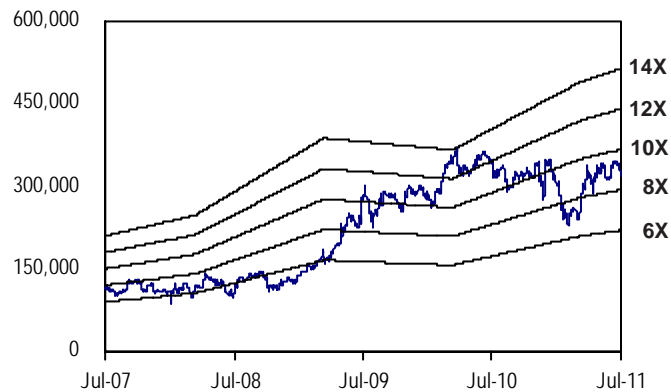
Balance Sheet	FY09	FY10	FY11P	FY12E	FY13E
Equity capital	399	399	399	399	399
Reserves & surplus	37,608	34,251	28,998	39,478	51,222
Shareholders' funds	38,008	34,650	29,397	39,878	51,621
Preference Share Capital	-	-	-	-	-
Total Debt	785	660	14,912	1,949	27
Capital Employed	38,792	35,311	44,309	41,826	51,648
Net fixed assets	16,943	17,069	42,054	42,532	36,034
Cash & Cash Eq.	35,527	57,973	51,483	30,872	42,148
Net other Current Assets	(12,589)	(38,560)	(47,117)	(29,315)	(24,121)
Investments	357	357	357	357	357
Net Deferred Tax Assets	(1,444)	(1,528)	(2,468)	(2,620)	(2,770)
Total assets	38,792	35,311	44,309	41,826	51,648

Key Ratios	FY09	FY10	FY11P	FY12E	FY13E
EBITDA margin (%)	14.3	17.5	13.5	15.3	15.5
Net margin (%)	10.4	14.2	10.3	9.8	9.9
Dividend yield (%)	1.1	6.1	5.9	2.8	3.4
Net debt/Equity (x)	(0.9)	(1.7)	(1.2)	(0.7)	(0.8)
Net Working Capital (days)	(10)	(18)	(24)	(2)	(2)
Asset turnover (x)	2.2	2.2	2.0	2.3	2.7
ROCE (%)	49.0	73.4	59.7	60.2	66.7
RoE (%)	37.8	61.4	61.9	64.0	56.3
EV/Net sales (x)	2.6	1.9	1.7	1.4	1.2
EV/EBITDA (x)	18.3	10.8	12.3	9.4	7.8
PER (x)	27.9	16.0	18.0	16.1	13.9
Price/Book (x)	9.4	10.3	12.2	9.0	6.9

P/E Band



EV/EBITDA



**T E A M**

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