

## RESULT UPDATE

### LARGE CAP

#### Share Data

Reuters code	HROH.BO
Bloomberg code	HH IN
Market cap. (US\$ mn)	7,022
6M avg. daily turnover (US\$ mn)	19.2
Issued shares (mn)	200
Target price (Rs)	1,748

#### Performance (%) 1M 3M 12M

Absolute	(7)	2	92
Relative	(3)	3	(1)

#### Valuation ratios

Yr to 31 Mar	FY10E	FY11E
EPS (Rs)	109.4	116.5
+/- (%)	70.4	6.5
PER (x)	14.8	13.9
PBV (x)	5.9	4.4
Dividend/Yield (%)	1.2	1.2
EV/Sales (x)	1.7	1.6
EV/EBITDA (x)	10.0	9.7

#### Major shareholders (%)

Promoters	55
FII's	29
MFs	4
BFSI's	4
Public & Others	8

#### Financial highlights

(Rs mn)	Dec 09	Dec 08	YoY (%)	Sep 09	QoQ (%)	9MFY10	9MFY09	YoY (%)	FY10E	YoY (%)	FY11E	YoY (%)
Net Sales	38,270	28,813	32.8	40,594	(5.7)	117,089	89,269	31.2	157,466	27.8	172,255	9.4
EBITDA	6,609	4,170	58.5	7,442	(11.2)	20,552	11,929	72.3	27,384	58.4	28,112	2.7
EBITDA Margins (%)	17.3	14.5	2.8	18.3	(1.1)	17.6	13.4	4.2	17.4	3.4	16.3	(1.1)
Other Income	550	436	26.1	687	(20.0)	1,661	1,442	15.2	2,461	4.5	2,991	21.5
Interest	(46)	(87)	(47.5)	(61)	(24.8)	(162)	(221)	(26.8)	30	18.6	20	(33.3)
Depreciation	469	475	(1.2)	503	(6.9)	1,428	1,363	4.8	1,934	7.1	2,177	12.5
PBT	6,736	4,219	59.7	7,686	(12.4)	20,947	12,229	71.3	27,881	56.5	28,906	3.7
Tax (%)	20.5	28.8	(8.3)	22.3	(1.9)	22.0	28.1	(6.0)	21.7	(6.4)	19.5	(2.1)
PAT	5,358	3,004	78.3	5,971	(10.3)	16,330	8,796	85.7	21,843	70.4	23,266	6.5
EPS (Rs)	26.8	15.0	78.3	29.9	(10.3)	81.8	44.0	85.7	109.4	70.4	116.5	6.5

## Hero Honda Motors

Maintain Outperformer

Price: Rs 1,621

BSE Index: 16,780

25 January 2010

### 3QFY10 Result – Tax rate falls further

**Hero Honda's (HH) performance was in-line with our expectations with a PAT of Rs 5.36 bn as against our expectations of Rs 5.33 bn. Net sales grew by 33% (30% volume and 2.5% realisation) to Rs 38.3 bn against our expectation of Rs 38.1 bn. Operating profit grew by 58.5% to Rs 6.6 bn with margins of 17.3% against our expectation of 17.1%. Higher contribution from tax haven plant at Haridwar (~32% of volumes) led to lower tax rate of 20.5% which resulted in 78.3% growth in PAT to Rs 5.36 bn. Tax rate is expected to remain at 20.5% for 4QFY10 and between 19-20% in FY11.**

We have realigned our volume and earnings assumptions (see page 2 for detailed assumptions) to factor in the stronger underlying demand in the two wheeler sector and lower tax rate. Consequently our FY10E and FY11E EPS are higher by 7.3% and 2.5%, respectively. We do not see much upside to our volume assumption of 7.6% for FY11.

As mentioned by us earlier (including our 2QFY10 result update) HH has lost marketshare to competition and we expect this trend to continue in FY11. We expect HH to counter increasing product based competition by leveraging its tax haven operation. As and when the excise rate is rolled back we expect HH to absorb bulk of the cost increase for Splendor and Passion and compensate for it by increased profitability of the Haridwar operations.

**We continue to remain overweight on the two-wheeler sector due to robust demand (not so much driven by liquidity) and limited competition. We do not expect the sector to see a repeat of price wars last seen in FY07, as we expect competition to be largely based on product rather than price. The stock is currently trading at 13.9x FY11E EPS which we think is attractive considering the strong balance sheet, asset light operations and defensive nature of business. Maintain Outperformer with a target price of Rs 1,748.**

## Key assumptions

(Units)	Revised		Earlier		YTD	Residual
	FY10E	FY11E	FY10E	FY11E	FY10	FY10E
Total volumes	4,586,108	4,936,126	4,335,995	4,711,472	3,413,594	1,172,514
YoY (%)	23.2	7.6	16.5	8.7	25.3	17.5
Realisation (Rs)	34,335	34,897	34,485	35,040	34,301	34,436
YoY (%)	3.7	1.6	4.2	1.6	4.7	0.4
EBITDA Margins (%)	17.4	16.3	17.1	17.0	17.6	16.9
EPS (Rs)	109.4	116.5	101.9	113.7	81.8	27.6
YoY (%)	70.4	6.5	58.8	11.5	85.7	37.3

## Vehicle sales

(Units)	Dec 09	Dec 08	YoY (%)	Sep 09	QoQ (%)	9MFY10	9MFY09	YoY (%)
<b>Total Sales</b>	<b>1,111,372</b>	<b>857,806</b>	<b>29.6</b>	<b>1,183,235</b>	<b>(6.1)</b>	<b>3,413,594</b>	<b>2,724,145</b>	<b>25.3</b>
Domestic	1,085,985	836,533	29.8	1,159,306	(6.3)	3,340,287	2,660,223	25.6
Exports	25,387	21,273	19.3	23,929	6.1	73,307	63,922	14.7
<b>Motorcycle</b>	<b>1,065,441</b>	<b>814,121</b>	<b>30.9</b>	<b>1,128,515</b>	<b>(5.6)</b>	<b>3,265,772</b>	<b>2,617,424</b>	<b>24.8</b>
Domestic	1,041,722	793,576	31.3	1,105,782	(5.8)	3,196,505	2,555,903	25.1
Exports	23,719	20,545	15.4	22,733	4.3	69,267	61,521	12.6
<b>Scooter</b>	<b>45,931</b>	<b>43,685</b>	<b>5.1</b>	<b>54,720</b>	<b>(16.1)</b>	<b>147,822</b>	<b>106,721</b>	<b>38.5</b>
Domestic	44,263	42,957	3.0	53,524	(17.3)	143,782	104,320	37.8
Exports	1,668	728	129.1	1,196	39.5	4,040	2,401	68.3

## Domestic motorcycle market share

(Units)	Dec 09	Dec 08	YoY (%)	Sep 09	QoQ (%)	9MFY10	9MFY09	YoY (%)
Industry Sales	1,818,698	1,305,344	39.3	1,831,309	(0.7)	5,339,738	4,368,885	22.2
Market Share (%)	57.3	60.8	(3.5)	60.4	(3.1)	59.9	58.5	1.4

## % of sales

	Dec 09	Dec 08	YoY (%)	Sep 09	QoQ (%)	9MFY10	9MFY09	YoY (%)
Material cost	68.3	70.2	(1.9)	68.1	0.2	68.1	71.5	(3.5)
Staff cost	3.6	4.0	(0.4)	3.4	0.2	3.5	3.7	(0.2)
Other expenses	10.8	11.3	(0.5)	10.2	0.7	10.9	11.4	(0.6)
<b>EBITDA margins</b>	<b>17.3</b>	<b>14.5</b>	<b>2.8</b>	<b>18.3</b>	<b>(1.1)</b>	<b>17.6</b>	<b>13.4</b>	<b>4.2</b>

## Per vehicle

(Rs)	Dec 09	Dec 08	YoY (%)	Sep 09	QoQ (%)	9MFY10	9MFY09	YoY (%)
Realisations	34,435	33,589	2.5	34,308	0.4	34,301	32,769	4.7
Material cost	23,526	23,570	(0.2)	23,357	0.7	23,342	23,440	(0.4)
Staff cost	1,234	1,347	(8.4)	1,172	5.3	1,214	1,210	0.3
Other expenses	3,728	3,811	(2.2)	3,490	6.8	3,725	3,740	(0.4)
<b>EBITDA</b>	<b>5,947</b>	<b>4,861</b>	<b>22.3</b>	<b>6,289</b>	<b>(5.4)</b>	<b>6,021</b>	<b>4,379</b>	<b>37.5</b>

Source: Company &amp; SIAM

**Income Statement**

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
<b>Net sales</b>	<b>103,318</b>	<b>123,191</b>	<b>157,466</b>	<b>172,255</b>
<i>Growth (%)</i>	<i>4.4</i>	<i>19.2</i>	<i>27.8</i>	<i>9.4</i>
Operating expenses	(89,781)	(105,901)	(130,082)	(144,143)
Operating profit	13,537	17,291	27,384	28,112
<b>EBITDA</b>	<b>13,537</b>	<b>17,291</b>	<b>27,384</b>	<b>28,112</b>
<i>Growth (%)</i>	<i>14.0</i>	<i>27.7</i>	<i>58.4</i>	<i>2.7</i>
Depreciation	(1,615)	(1,807)	(1,934)	(2,177)
Other income	2,189	2,356	2,461	2,991
<b>EBIT</b>	<b>14,111</b>	<b>17,840</b>	<b>27,911</b>	<b>28,926</b>
Interest paid	(20)	(25)	(30)	(20)
<b>Pre-tax profit (before non-recurring)</b>	<b>14,091</b>	<b>17,815</b>	<b>27,881</b>	<b>28,906</b>
<b>Pre-tax profit (after non-recurring)</b>	<b>14,091</b>	<b>17,815</b>	<b>27,881</b>	<b>28,906</b>
Tax (current + deferred)	(4,424)	(4,997)	(6,036)	(5,637)
Net profit (before Minority Interest, Pref. Dividend, etc.)	9,667	12,818	21,845	23,270
Reported PAT	9,667	12,818	21,845	23,270
<b>Adjusted net profit</b>	<b>9,667</b>	<b>12,818</b>	<b>21,845</b>	<b>23,270</b>
<i>Growth (%)</i>	<i>12.7</i>	<i>32.6</i>	<i>70.4</i>	<i>6.5</i>

**Balance Sheet**

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Cash & marketable sec.	26,885	34,997	51,002	71,247
Other current assets	8,022	7,829	13,350	13,431
Investments	94	886	357	357
Net fixed assets	15,648	16,942	15,482	15,435
Other non-current assets	52	87	87	87
<b>Total assets</b>	<b>50,701</b>	<b>60,740</b>	<b>80,277</b>	<b>100,557</b>
Current liabilities	18,212	20,417	23,232	24,765
Total debt	1,320	785	185	185
Other non-current liabilities	1,306	1,531	1,681	1,831
<b>Total liabilities</b>	<b>20,838</b>	<b>22,732</b>	<b>25,098</b>	<b>26,781</b>
Share capital	399	399	399	399
Reserves & surplus	29,463	37,608	54,780	73,377
<b>Shareholders' funds</b>	<b>29,862</b>	<b>38,008</b>	<b>55,180</b>	<b>73,777</b>
<b>Total equity &amp; liab.</b>	<b>50,701</b>	<b>60,740</b>	<b>80,277</b>	<b>100,557</b>
<b>Capital employed</b>	<b>32,488</b>	<b>40,323</b>	<b>57,046</b>	<b>75,792</b>

**Cash Flow Statement**

Yr end 31 Mar (Rs mn)	FY08	FY09	FY10E	FY11E
Pre-tax profit	14,091	17,815	27,881	28,906
Depreciation	1,615	1,807	1,934	2,177
Change in working capital	3,675	2,224	(2,738)	1,452
Total tax paid	(4,420)	(4,866)	(5,855)	(5,487)
<b>Cash flow from oper. (a)</b>	<b>14,960</b>	<b>16,979</b>	<b>21,222</b>	<b>27,048</b>
Capital expenditure	(3,567)	(2,895)	(475)	(2,130)
Change in investments	(5,930)	(8,019)	(2,716)	(5,000)
Others	(141)	(205)	0	0
<b>Cash flow from inv. (b)</b>	<b>(9,637)</b>	<b>(11,120)</b>	<b>(3,191)</b>	<b>(7,130)</b>
<b>Free cash flow (a+b)</b>	<b>5,323</b>	<b>5,859</b>	<b>18,032</b>	<b>19,918</b>
Debt raised/(repaid)	(332)	(535)	(600)	0
Dividend (incl. tax)	(3,972)	(4,439)	(4,673)	(4,673)
Others	(67)	0	0	0
<b>Cash flow from fin. (c)</b>	<b>(4,370)</b>	<b>(4,974)</b>	<b>(5,273)</b>	<b>(4,673)</b>
<b>Net chg in cash (a+b+c)</b>	<b>953</b>	<b>885</b>	<b>12,759</b>	<b>15,246</b>

**Key Ratios**

Yr end 31 Mar (%)	FY08	FY09	FY10E	FY11E
Adjusted EPS (Rs)	48.4	64.2	109.4	116.5
Growth	12.7	32.6	70.4	6.5
Book NAV/share (Rs)	149.5	190.3	276.3	369.4
Dividend/share (Rs)	19.0	20.0	20.0	20.0
Dividend payout ratio	45.9	36.5	21.4	20.1
Tax	31.4	28.1	21.7	19.5
EBITDA margin	13.1	14.0	17.4	16.3
EBIT margin	13.7	14.5	17.7	16.8
RoCE	46.9	49.0	57.3	43.6
Net debt/Equity	(85.6)	(90.0)	(92.1)	(96.3)

**Valuations**

Yr end 31 Mar (x)	FY08	FY09	FY10E	FY11E
PER	33.5	25.3	14.8	13.9
PCE	28.7	22.1	13.6	12.7
Price/Book	10.8	8.5	5.9	4.4
Yield (%)	1.2	1.2	1.2	1.2
EV/Net sales	2.6	2.2	1.7	1.6
EV/EBITDA	20.2	15.8	10.0	9.7

**Du Pont Analysis – ROE**

Yr end 31 Mar (x)	FY08	FY09	FY10E	FY11E
Net margin (%)	9.4	10.4	13.9	13.5
Asset turnover	2.2	2.2	2.2	1.9
Leverage factor	1.7	1.6	1.5	1.4
Return on equity (%)	35.4	37.8	46.9	36.1

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  3. **UNDERPERFORMER:** 0 to -25%
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