

Near fair value post-rally

Bank of America
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Raise PO, but maintain Neutral

Raise PO by 14% to Rs 2,012, driven by (1) upward revision of EPS forecasts by 5%-7% over FY11-12E, and (2) re-rating of core business on growth visibility and positive triggers (high dividend payout, possible entry into new export markets). Rate Neutral following 17% YTD stock rally, and limited potential upside.

Forecast 14.5% sales CAGR

Our assumptions are above street estimates, based on (1) strategic launches in bikes and scooters, which will enhance competitive position, and (2) easing of capacity constraints. We expect high utilisation rates, our increased confidence stemming from proposed investment in 4th plant to cater to demand beyond FY11.

Margin cushioning from tax free unit

Our forecasts factor 103bps cumulative decline in margins over FY10-12E, with higher input and emission related costs cushioned by increased production at Hardwar (~50% of incremental sales). We estimate profitability in tax free unit to be 20% higher than older plants.

Valued on constituent businesses

Our PO is based on sum of (1) two wheeler valued at 15x at Rs 1,699/share, and (2) cash of Rs 313/share. At PO, the stock will trade at 16x FY11E P/E (earlier 15x), which is 5% discount to market compared to historical discount of 18%, on improved growth visibility, strong cash flows and financial position.

Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012E
Net Income (Adjusted - mn)	9,679	12,820	21,679	24,949	28,253
EPS	48.47	64.20	108.56	124.93	141.48
EPS Change (YoY)	12.8%	32.4%	69.1%	15.1%	13.2%
Dividend / Share	19.00	20.00	40.00	40.00	50.00
Free Cash Flow / Share	56.75	68.58	117.23	129.70	143.11

Valuation (Mar)

	2008A	2009A	2010E	2011E	2012E
P/E	40.59x	30.65x	18.12x	15.75x	13.91x
Dividend Yield	0.966%	1.02%	2.03%	2.03%	2.54%
EV / EBITDA*	27.60x	21.82x	13.85x	12.51x	11.27x
Free Cash Flow Yield*	2.88%	3.49%	5.96%	6.59%	7.27%

* For full definitions of *iQmethod*SM measures, see page 5.

Stock Data

Price	Rs1,967
Price Objective	Rs2,012
Date Established	31-Mar-2010
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs1,011-Rs2,080
Mrkt Val / Shares Out (mn)	US\$8,713 / 199.7
Average Daily Volume	519,418
BofAML Ticker / Exchange	HRHDF / BSE
Bloomberg / Reuters	HH IN / HROH.BO
ROE (2010E)	50.0%
Net Dbt to Eqty (Mar-2009A)	-3.7%
Est. 5-Yr EPS / DPS Growth	15.0% / 15.0%
Free Float	45.0%

Key Changes

(Rs)	Previous	Current
Price Obj.	1,760.00	2,012.00
2010E Rev (m)	156,871.2	157,164.1
2011E Rev (m)	173,278.6	182,989.2
2012E Rev (m)	191,677.5	205,311.2
2010E EPS	107.56	108.56
2011E EPS	118.51	124.93
2012E EPS	132.19	141.48
2010E EBITDA (m)	27,440.8	27,513.8
2011E EBITDA (m)	29,080.1	30,455.2
2012E EBITDA (m)	31,969.5	33,817.8
2010E DPS	30.00	40.00

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 10924458

31 March 2010

iQprofileSM Hero Honda

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012E
(Rs Millions)					
Sales	103,631	123,562	157,164	182,989	205,311
Gross Profit	25,771	31,655	44,838	50,498	56,528
Sell General & Admin Expense	(11,964)	(14,187)	(17,325)	(20,043)	(22,710)
Operating Profit	12,204	15,661	25,573	28,092	31,355
Net Interest & Other Income	1,900	2,156	2,131	2,901	3,741
Associates	0	0	0	0	0
Pretax Income	14,103	17,817	27,705	30,993	35,096
Tax (expense) / Benefit	(4,424)	(4,997)	(6,026)	(6,044)	(6,844)
Net Income (Adjusted)	9,679	12,820	21,679	24,949	28,253
Average Fully Diluted Shares Outstanding	200	200	200	200	200

Key Cash Flow Statement Data

Net Income	9,679	12,820	21,679	24,949	28,253
Depreciation & Amortization	1,603	1,807	1,941	2,364	2,463
Change in Working Capital	2,731	(413)	1,454	1,202	971
Deferred Taxation Charge	12	191	60	60	68
Other Adjustments, Net	844	2,553	1,276	500	(1)
Cash Flow from Operations	14,869	16,958	26,410	29,075	31,754
Capital Expenditure	(3,536)	(3,262)	(3,000)	(3,175)	(3,175)
(Acquisition) / Disposal of Investments	(5,930)	(8,019)	(500)	(500)	(500)
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(9,465)	(11,281)	(3,500)	(3,675)	(3,675)
Shares Issue / (Repurchase)	0	0	0	0	0
Cost of Dividends Paid	(4,439)	(4,673)	(10,934)	(10,934)	(13,667)
Cash Flow from Financing	(4,771)	(5,208)	(11,719)	(10,934)	(13,667)
Free Cash Flow	11,333	13,696	23,410	25,900	28,579
Net Debt	9	(1,411)	(13,387)	(27,854)	(42,265)
Change in Net Debt	(965)	(1,004)	(11,976)	(14,467)	(14,412)

Key Balance Sheet Data

Property, Plant & Equipment	11,563	15,737	16,796	17,608	18,320
Other Non-Current Assets	29,805	34,979	35,493	35,993	36,493
Trade Receivables	2,974	1,499	1,550	1,905	2,137
Cash & Equivalents	1,311	2,196	13,387	27,854	42,265
Other Current Assets	5,083	6,440	6,934	7,364	7,507
Total Assets	50,736	60,851	74,160	90,723	106,723
Long-Term Debt	1,320	785	0	0	0
Other Non-Current Liabilities	1,306	1,531	1,591	1,651	1,720
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	18,247	20,528	23,816	26,304	27,649
Total Liabilities	20,873	22,844	25,407	27,955	29,369
Total Equity	29,862	38,008	48,753	62,768	77,354
Total Equity & Liabilities	50,736	60,851	74,160	90,723	106,723

iQmethodSM - Bus Performance*

Return On Capital Employed	29.0%	32.1%	45.1%	40.9%	37.0%
Return On Equity	35.5%	37.8%	50.0%	44.7%	40.3%
Operating Margin	12.6%	13.6%	17.2%	16.1%	16.0%
EBITDA Margin	13.3%	14.1%	17.5%	16.6%	16.5%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.5x	1.3x	1.2x	1.2x	1.1x
Asset Replacement Ratio	2.2x	1.8x	1.5x	1.3x	1.3x
Tax Rate (Reported)	31.4%	28.0%	21.8%	19.5%	19.5%
Net Debt-to-Equity Ratio	0%	-3.7%	-27.5%	-44.4%	-54.6%
Interest Cover	NM	NM	NA	NA	NA

Key Metrics

* For full definitions of iQmethodSM measures, see page 5.

Company Description

Hero Honda is the largest domestic manufacturer of motorcycles operating out of two manufacturing locations in Haryana, North India. The company is a JV promoted by Hero Cycles of India (promoters - Munjal Group) and Honda motors of Japan (26% stake). The latter provides financial and technology support. Its key models include Splendour and Passion Plus (100cc), Super Splendour (125 cc), Ambition (135 cc), CBZ(155 cc) and Karizma (225 cc).

Investment Thesis

We rate Hero Honda Neutral following sharp 17% YTD stock rally, limiting potential upside. Over the longer term, the company's strong business fundamentals should enable increase penetration, and maintain steady growth.

Stock Data

Price to Book Value 8.1x

Table 1: Revision of estimates

(Rs bn)	Old			New			Revision		
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Net sales	156.9	173.3	191.7	157.2	183.0	205.3	0.2%	5.6%	7.1%
EBITDA	27.4	29.1	32.0	27.5	30.5	33.8	0.3%	4.7%	5.8%
Margins	17.5%	16.8%	16.7%	17.5%	16.6%	16.5%	1bps	-14bps	-21bps
PAT	21.5	23.7	26.4	21.7	24.9	28.3	0.9%	5.4%	7.0%

Source: BofA Merrill Lynch Global Research

Table 2: Revision of volumes

('000s)	Old			New			Revised growth		
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Volumes									
Domestic	4480	4920	5424	4492	5257	5885	23.5%	17.0%	12.0%
Exports	96	114	115	93	107	123	10.0%	15.0%	15.0%
Total	4576	5034	5539	4585	5364	6009	23.2%	17.0%	12.0%

Source: BofA Merrill Lynch Global Research

Price objective basis & risk

Hero Honda (HRHDF)

Our PO of Rs 2012 is based on sum of two wheeler business valued at 15x or Rs 1699/share and cash & cash equivalents of Rs 313/share . Risks: New models from competition, and higher interest rates, both of which could impact sales. Higher input costs will also impact profitability.

Link to Definitions

Industrials

Click [here](#) for definitions of commonly used terms.

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	Eicher Motors	XEICF	EIM IN	S.Arun
	Maruti Suzuki India	MUDGF	MSIL IN	S.Arun
	Tata Motors Ltd.	TTM	TTM US	S.Arun
	Tata Motors Ltd.	TENJF	TTMT IN	S.Arun
	TVS Motor	XFKMF	TVSL IN	S.Arun
NEUTRAL				
	Bajaj Auto	XBJBF	BJAUT IN	S.Arun
	Hero Honda	HRHDF	HH IN	S.Arun

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India - Autos Coverage Cluster

Investment rating	Company	BofAML ticker	Bloomberg symbol	Analyst
UNDERPERFORM				
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	M & M	MAHHF	MM IN	S.Arun
	M & M -G	MAHMF	MHID LI	S.Arun
RVW				
	Bharat Forge	XUUVF	BHFC IN	S.Arun

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

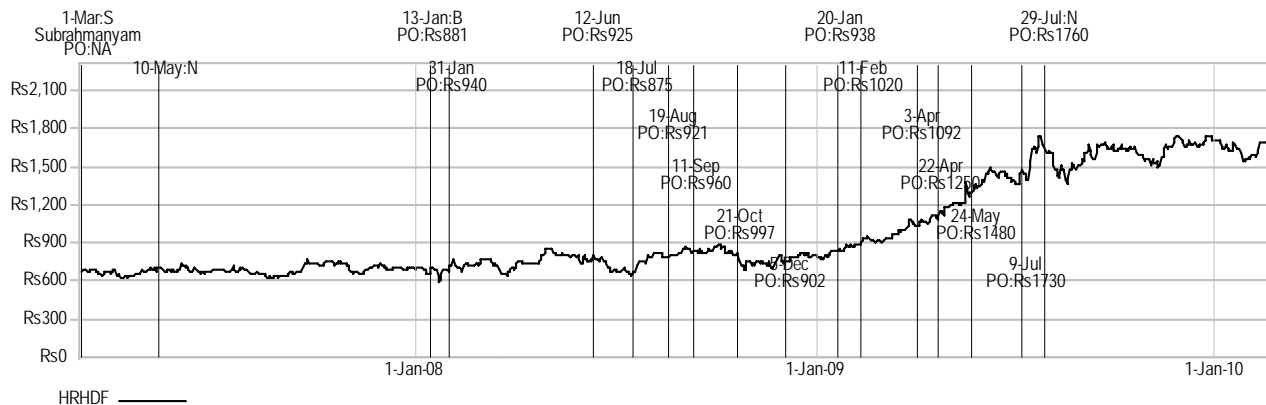
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B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of February 28, 2010 or such later date as indicated.

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	45	59.21%	Buy	26	70.27%
Neutral	17	22.37%	Neutral	8	61.54%
Sell	14	18.42%	Sell	9	75.00%

Investment Rating Distribution: Global Group (as of 01 Jan 2010)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1699	50.78%	Buy	904	58.82%
Neutral	841	25.13%	Neutral	491	65.03%
Sell	806	24.09%	Sell	368	49.80%

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