

Hero Honda Motors Ltd.

BLOOMBERG: HH IN EQUITY | BSE: 500182 | NSE: HEROHONDA

Stock price fully valuing even the bull case

Hero Honda (HH) in our opinion continues to look expensive, amongst other auto OEMs, trading at 16.2x FY12E earnings, even on an ex-dividend basis. We note that at CMP, the stock discounts a bull-case scenario (18% YoY volume growth; 100 bps margin expansions over Q3) by 13.1x earnings – its long-term trading average. We believe that though volumes will remain buoyant, margins are likely to remain subdued in FY12/FY13, leading to an earnings CAGR of just 6% over FY11-FY13 and a contraction of earnings multiple. Reiterate SELL.

- ❖ **Street unduly optimistic on HH margins:** Our FY12 EBITDA margin estimates for HH stands at 11.5% (110bps below consensus), a ~100 bps decline from Q3FY11 levels, to factor in higher costs related to R&D expenses, re-branding exercises and costs for setting up export channels. We believe there could be further negative surprises on the margin front if commodity prices firm up further. Currently, consensus EBITDA margin estimates for HH for FY12/FY13 stand at 12.6%, higher than the most recent quarter's normalized margins of 12.4%. This is counter-intuitive as the street is generally building in a scenario of margin compression for the rest of the auto pack.
- ❖ **Gross margins decline for HH inline with that of BJAUT – don't expect steeper EBITDA margin decline to catch-up:** We note that raw material costs for both HH and Bajaj Auto (BJAUT) have increased 500-600 bps off lows and the impact on EBITDA margins could have been similar. However unlike HH, BJAUT cut down on its expenses on marketing and ad-spends and was able to offset the impact of higher commodity prices - the resulting impact on BJAUT's margins from its peak levels was at 250 bps. Hero Honda failed to counter the increase in raw material which shaved off 490 bps from peak margins.
- ❖ **Re-iterate Sell; TP at Rs 1,460:** We believe that at CMP, the HH stock price factors in a bull case scenario (see Fig 3) and chances of negative surprises especially on margins remain high. We reiterate our SELL recommendation on HH with a target price of Rs 1,460, based on 13x Dec '12 earnings.

Financial highlights

Year End: 31 Mar	FY09A	FY10A	FY11E	FY12E	FY13E
Revenue (Rs mn)	123,191	158,561	192,003	220,542	248,522
EBITDA (Rs mn)	17,118	27,660	24,778	25,318	27,438
Adj. PAT (Rs mn)	12,818	22,380	20,402	21,107	22,757
Adj. EPS (Rs)	64.2	112.1	102.2	105.7	114.0
Growth (%)	31.8	74.6	(8.8)	3.5	7.8
DPS (Rs)	19.0	110.0	70.0	45.0	50.0
ROIC (%)	30.1	125.0	49.3	37.7	36.2
ROE (%)	33.7	64.6	52.3	42.4	37.3
P/E (x)	20.9	16.5	18.2	17.6	16.4
EV/EBITDA (x)	13.6	11.3	13.0	12.7	11.2
P/BV (x)	7.1	10.7	9.5	7.5	6.1

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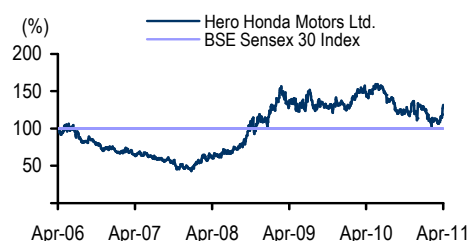
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CMP	Rs 1,864
Target	Rs 1,460
Previous	Rs 1,460
Rating	SELL
Previous	SELL
% Upside / (Downside)	(22)%
+ Dividend yield	4%
Total return	(18)%

Company data

Market cap (Rs mn / US\$ mn)	372,211 / 8,372
Outstanding equity shares (mn)	199.7
BVPS (Rs)	195
Free float (%)	48.0
52-week high / low (Rs)	2,058 / 1,391
2-month avg. daily vol (mn)/ value (US\$ mn)	1 / 27
ADR/GDR premium (%)	

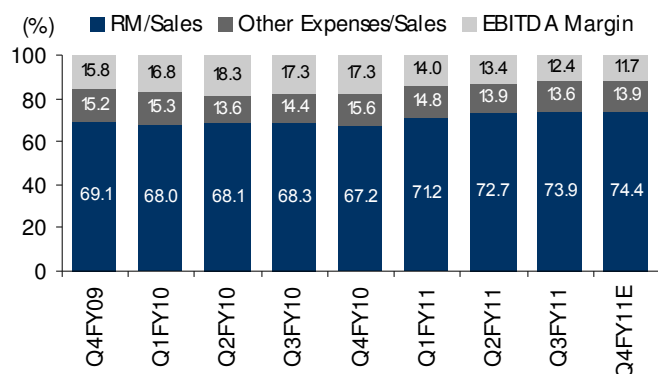
Stock performance



In the interest of timeliness this report has not been edited.

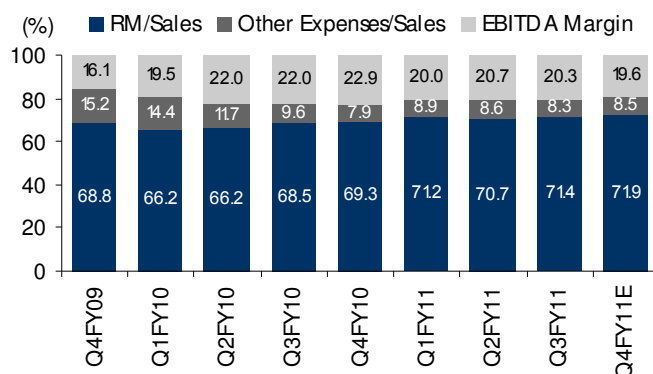


Fig 1 - Hero Honda – Quarterly Cost Trend



Source: RCML Research, Company

Fig 2 - Bajaj Auto - Quarterly Cost Trend



Source: RCML Research, Company

Fig 3 - EPS Matrix at different volumes and margin estimates || Implied Valuation at current market price of Rs 1,832

EPS Matrix at different volumes and margin estimates (Rs.) [Base case – Volumes 6mn units; Margins – 11.5%]						
Volume (mn units)		5.6	5.8	6.0	6.2	6.4
Implied YoY % growth		3.7	7.4	11.1	14.8	18.5
EBITDA margin (%)	13.5	114.1	118.1	122.0	126.0	129.9
	12.5	105.9	109.6	113.3	116.9	120.6
	11.5	97.7	101.1	104.5	107.8	111.2
	10.5	89.5	92.6	95.7	98.8	101.8
	9.5	81.3	84.1	86.9	89.7	92.5
Implied P/E ratio corresponding to each volume/margin scenario						
Implied valuation at CMP (x) (ex-dividend)		14.9	14.4	13.9	13.5	13.1
		16.0	15.5	15.0	14.5	14.1
		17.4	16.8	16.2	15.7	15.3
		19.0	18.3	17.7	17.2	16.7
		20.9	20.2	19.5	18.9	18.4

Source: RCML Research

Profit and Loss statement

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Total revenue	123,191	158,561	192,003	220,542	248,522
EBITDA	17,118	27,660	24,778	25,318	27,438
EBIT	15,311	25,746	22,555	22,811	24,718
Interest	2,504	2,633	2,846	3,362	4,038
Other income/(Expense)	0	0	0	0	0
Exceptional items	0	(62)	0	0	0
EBT	17,815	28,317	25,401	26,173	28,756
Income taxes	(4,997)	(5,999)	(4,999)	(5,065)	(5,999)
Extraordinary items	0	0	0	0	0
Min int./Inc. from associates	0	0	0	0	0
Reported net profit	12,818	22,318	20,402	21,107	22,757
Adjustments	0	62	0	0	0
Adjusted net profit	12,818	22,380	20,402	21,107	22,757

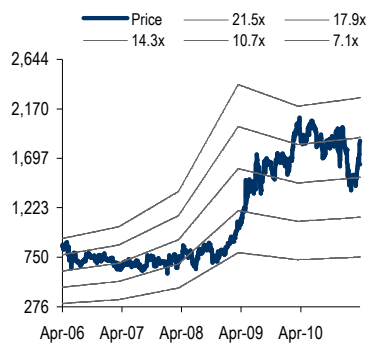
Balance sheet

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Accounts payable	7,030	11,114	13,151	13,897	13,618
Other current liabilities	8,228	26,936	10,961	10,961	12,426
Provisions	5,270	10,264	16,076	10,334	11,483
Debt funds	785	660	660	660	660
Other liabilities	0	0	0	0	0
Equity capital	399	399	399	399	399
Reserves & surplus	37,608	34,251	38,577	49,349	60,624
Shareholder's funds	38,008	34,650	38,976	49,749	61,023
Total liabilities	59,321	83,625	79,824	85,602	99,210
Cash and cash eq	35,883	58,329	50,024	52,551	64,586
Accounts receivable	1,499	1,084	1,578	1,813	2,043
Inventories	3,268	4,364	5,369	6,061	6,621
Other current assets	3,172	4,306	4,816	5,298	6,200
Investments	0	0	0	0	0
Net fixed assets	15,737	16,588	18,615	20,358	20,138
CWIP	1,205	481	750	650	550
Intangible assets	0	0	0	0	0
Deferred tax assets, net	(1,444)	(1,528)	(1,328)	(1,128)	(928)
Other assets	0	0	0	0	0
Total assets	59,321	83,625	79,824	85,602	99,210

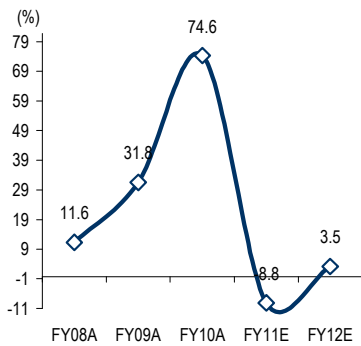
Cash flow statement

Y/E 31 Mar (Rs mn)	FY09A	FY10A	FY11E	FY12E	FY13E
Net income + Depreciation	14,624	24,233	22,624	23,615	25,477
Interest expenses	(537)	(558)	21	21	21
Non-cash adjustments	0	0	0	0	0
Changes in working capital	985	4,846	(16,366)	(662)	(507)
Other operating cash flow	(1,482)	(1,675)	(200)	(200)	(200)
Cash flow from operations	13,590	26,846	6,080	22,774	24,791
Capital expenditure	(3,151)	(2,116)	(4,519)	(4,150)	(2,400)
Change in investments	(6,677)	(3,618)	(7,851)	(3,769)	(6,105)
Other investing cash flow	715	458	0	0	0
Cash flow from investing	(9,112)	(5,276)	(12,370)	(7,919)	(8,505)
Issue of equity	0	0	0	0	0
Issue/repay debt	(535)	(125)	0	0	0
Interest expenses	(25)	(21)	(21)	(21)	(21)
Dividends paid	(3,794)	(20,948)	(9,845)	(16,076)	(10,334)
Other financing cash flow	323	18,446	0	0	0
Cash flow from financing	(4,032)	(2,647)	(9,866)	(16,097)	(10,355)
Change in cash & cash eq	447	18,923	(16,157)	(1,242)	5,930
Closing cash & cash eq	1,696	19,072	2,915	1,674	7,604

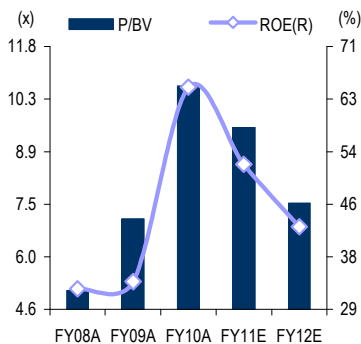
1-yr fwd P/E band



EPS growth



ROE vs P/BV



Per share data

Y/E 31 Mar (Rs)	FY09A	FY10A	FY11E	FY12E	FY13E
Reported EPS	64.2	111.8	102.2	105.7	114.0
Adjusted EPS	64.2	112.1	102.2	105.7	114.0
DPS	19.0	110.0	70.0	45.0	50.0
BVPS	190.3	173.5	195.2	249.1	305.6

Valuation ratios

Y/E 31 Mar (x)	FY09A	FY10A	FY11E	FY12E	FY13E
EV/Sales	1.9	2.0	1.7	1.5	1.2
EV/EBITDA	13.6	11.3	13.0	12.7	11.2
P/E	20.9	16.5	18.2	17.6	16.4
P/BV	7.1	10.7	9.5	7.5	6.1

Financial ratios

Y/E 31 Mar	FY09A	FY10A	FY11E	FY12E	FY13E
Profitability & Return ratios (%)					
EBITDA margin	13.9	17.4	12.9	11.5	11.0
EBIT margin	12.4	16.2	11.7	10.3	9.9
Net profit margin	10.4	14.1	10.6	9.6	9.2
ROE	33.7	64.6	52.3	42.4	37.3
ROCE	28.4	57.5	45.7	36.5	31.7
Working Capital & Liquidity ratios					
Receivables (days)	4	2	3	3	3
Inventory (days)	14	15	14	14	13
Payables (days)	29	37	34	31	27
Current ratio (x)	2.1	1.4	1.5	1.9	2.1
Quick ratio (x)	2.0	1.3	1.4	1.7	1.9
Turnover & Leverage ratios (x)					
Gross asset turnover	4.9	5.8	6.0	6.1	6.5
Total asset turnover	2.1	1.9	2.4	2.6	2.5
Interest coverage ratio	765.6	1,226.0	1,074.0	1,086.2	1,177.0
Adjusted debt/equity	0.0	0.0	0.0	0.0	0.0

Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	38,270	41,223	42,966	45,520	51,617
YoY growth (%)	32.8	20.8	12.7	12.1	34.9
QoQ growth (%)	(5.7)	7.7	4.2	5.9	13.4
EBITDA (Rs mn)	6,609	7,117	6,025	6,079	6,426
EBITDA margin (%)	17.3	17.3	14.0	13.4	12.4
Adj PAT (Rs mn)	5,358	5,988	4,917	5,056	5,425
YoY growth (%)	78.3	48.9	0.6	(15.3)	1.3
QoQ growth (%)	(10.3)	11.8	(17.9)	2.8	7.3

DuPont analysis

(%)	FY09A	FY10A	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	71.9	79.0	80.3	80.6	79.1
Interest burden (PBT/EBIT)	116.4	110.0	112.6	114.7	116.3
EBIT margin (EBIT/Revenue)	12.4	16.2	11.7	10.3	9.9
Asset turnover (Revenue/Avg TA)	207.7	189.6	240.5	257.6	250.5
Leverage (Avg TA/Avg equity)	156.1	241.3	204.8	172.1	162.6
Return on equity	33.7	64.6	52.3	42.4	37.3

Company profile

Hero Honda, the largest two wheeler manufacturer in the world, is a joint venture between Hero Group and Honda Motor Co. It had a domestic market share of 48% in two-wheelers category in FY10 selling 4.6 mn units. The newly commissioned Haridwar plant, with several fiscal benefits from the state government, will take the total manufacturing capacity to 5.8 mn units by FY11.

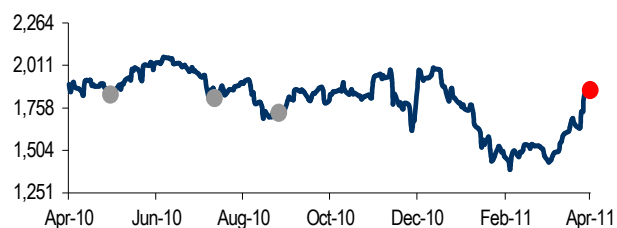
Shareholding pattern

(%)	Jun-11	Sep-11	Dec-11
Promoters	55.0	52.2	52.2
FIs	30.0	31.2	33.5
Banks and FIs	6.7	6.0	4.6
Public	8.3	10.6	9.8

Recommendation history

Date	Report type	Stock price	Target	Reco
25-Jan-10	Results Review	1,621	1,814	Hold
18-May-10	Company Update	1,849	2,100	Hold
30-Jul-10	Results Review	1,874	1,900	Hold
13-Sep-10	Sector Update	1,733	1,925	Hold
31-Oct-10	Results Review	1,865	1,900	Hold
19-Dec-10	Company Update	1,682	1,800	Hold
7-Mar-11	Sector Update	1,533	1,460	Sell
19-Apr-11	Company Update	1,864	1,460	Sell

Stock performance



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