



Hero Honda

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,101	HH IN
	REUTERS CODE
S&P CNX: 2.797	HROH.BO

20 January 2009

Buy

Rs834

Previous Recommendation: Buy

Equity Shares (m)	199.7
52-Week Range	895/561
1,6,12 Rel. Perf. (%)	11/56/77
M.Cap. (Rs b)	167.9
M.Cap. (US\$ b)	3.4

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	99,000	8,579	43.0	-11.7	19.6	6.8	38.3	48.2	1.5	12.7
3/08A	103,318	9,679	48.5	12.8	17.4	5.6	35.5	45.7	1.4	10.5
3/09E	117,712	12,158	60.9	25.6	13.8	4.6	36.5	46.0	1.1	8.4
3/10E	124,778	15,176	76.0	24.8	11.1	3.6	36.6	45.2	1.0	6.4

- Hero Honda's 3QFY09 operating performance was above our estimates with EBITDA margins of 14.3% and EBITDA of Rs4.1b. However lower other income and higher tax provisioning restricted PAT growth to 9.2% YoY to Rs3b.
- Revenues grew by 4.8% to Rs28.7b, driven by 9% higher realizations. While reported volumes declined by 4%, retail sales grew by 3.5% growth. Improvement in realizations is driven by price increases taken in 1HFY09 and part retention of excise cut in December 2008 (on selected models).
- EBITDA margins expanded by 40bp YoY (~110bp QoQ) to 14.3%, aided by lower RM cost (~60bp YoY and 240bp QoQ savings) – partial reflection of lower commodity prices. Margins would have been higher but for inventory loss of Rs170-190m (~60bp impact) due to excise duty cut, which was accounted for in 3QFY09.
- There has been decline of 240bp QoQ in RM cost driven by significant decline in commodity prices. There would be further benefits as it is yet to get benefits of certain commodities (carbon steel, alloy wheels etc) in 4QFY09. This coupled with ramp-up at Haridwar (~2,89,000 units in 4QFY09) would drive margin expansion of 100bp QoQ in 4QFY09.
- We have marginally revised our earnings estimates upward for FY09 by 2.4% to Rs60.9, but maintain FY10E EPS at Rs76. The change in estimates is to factor in for higher realizations and higher RM cost savings. The stock trades at 13.8x FY09 EPS and 11.1x FY10 EPS. Maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

Y/E MARCH	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Total Volumes (nos)	802,853	756,633	893,581	884,075	894,244	972,095	857,806	855,288	3,337,142	3,579,433
Change (%)	-3.6	0.6	-0.3	3.3	11.4	28.5	-4.0	-3.3	0.0	7.3
Net Sales	24,480	23,521	27,431	27,887	28,435	31,897	28,740	28,640	103,318	117,712
Change (%)	3.5	5.5	2.9	5.6	16.2	35.6	4.8	2.7	4.4	13.9
Total Cost	21,845	20,606	23,605	23,768	25,025	27,672	24,643	24,256	89,824	101,595
EBITDA	2,635	2,915	3,826	4,118	3,410	4,226	4,098	4,384	13,494	16,118
As % of Sales	10.8	12.4	13.9	14.8	12.0	13.2	14.3	15.3	13.1	13.7
Other Income	389	393	521	551	467	662	508	622	1,854	2,260
Interest	-90	-101	-87	-81	-50	-83	-87	-60	-358	-280
Depreciation	376	384	408	435	422	466	475	497	1,603	1,860
PBT	2,737	3,024	4,026	4,316	3,505	4,505	4,219	4,569	14,103	16,798
Tax	839	980	1,276	1,329	777	1,442	1,214	1,208	4,424	4,640
Effective Tax Rate (%)	30.6	32.4	31.7	30.8	22.2	32.0	28.8	26.4	31.4	27.6
PAT	1,898	2,043	2,750	2,987	2,729	3,063	3,004	3,362	9,679	12,158
Adj. PAT	1,898	2,043	2,750	2,987	2,729	3,063	3,004	3,362	9,679	12,158
Change (%)	-20.1	-5.4	31.5	47.1	43.7	49.9	9.2	12.6	11.8	25.6

E: MOSL Estimates

Hero Honda continues to outperform industry

In 3QFY09, HH's volumes declined only by 4% YoY to 857,806 units, while two-wheeler industry volumes de-grew 10% YoY. As a result, HH was able to improve its market share by 450bp in motorcycles and by 270bp in overall two-wheelers in 3QFY09. In domestic motorcycle market, it has improved its market share by 910bp to 60.8% - highest ever for the company.

VOLUME BREAK-UP

	3QFY09	3QFY08	YOY % CHG	2QFY09	QOQ % CHG
Volume (units)					
75cc - 125cc Motorcycles	769,148	815,338	-5.7	888,075	-2.0
% of Total	89.7	91.2		91.4	
125cc - 250cc Motorcycles	44,973	46,683	-3.7	46,452	31.0
% of Total	5.2	5.2		4.8	
Total Motorcycles	814,121	862,021	-5.6	934,527	-0.2
% of Total	94.9	96.5		96.1	
Scooters	43,685	31,560	38.4	37,568	-23.4
% of Total	5.1	3.5		3.9	
Total Two-wheelers	857,806	893,581	-4.0	972,095	-1.1
Of Which Exports	21,273	17,899	18.9	25,494	71.6
% of Total	2.5	2.0		2.6	

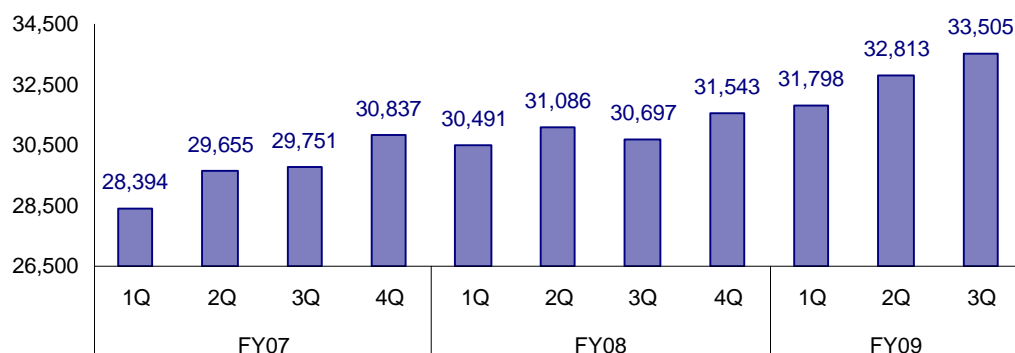
MARKET SHARE IMPROVES (INCLUDING EXPORTS)

	3QFY09	3QFY08	CHG (BP)	2QFY09	CHG (BP)
75cc - 125cc Motorcycles	73.7	64.2	950	69.1	460
125cc - 250cc Motorcycles	8.7	8.6	10	8.7	10
Total Motorcycles	51.9	47.3	450	51.0	90
Scooters	14.5	11.6	290	12.2	230
Total Two-wheelers	43.3	40.6	270	42.9	40

Source: Company/MOSL

Revenues grew by 4.8% to Rs28.7b, driven by 9% higher realizations. While volumes declined by 4%, retail sales grew by 3.5% growth. Improvement in realizations is driven by price increases taken in 1HFY09 and part retention of excise cut in Dec 2008 (on selected models). During the quarter, the company produced and sold about 1,50,000 units (v/s est. 200,000 units) from Haridwar (~46,000 units in 1QFY09 and ~1,15,000 in 2QFY09). The management is maintaining its full year target of 600,000 units from Haridwar.

NET REALIZATIONS IMPROVE DUE PRICE HIKES (PER UNIT REALIZATION, RS)



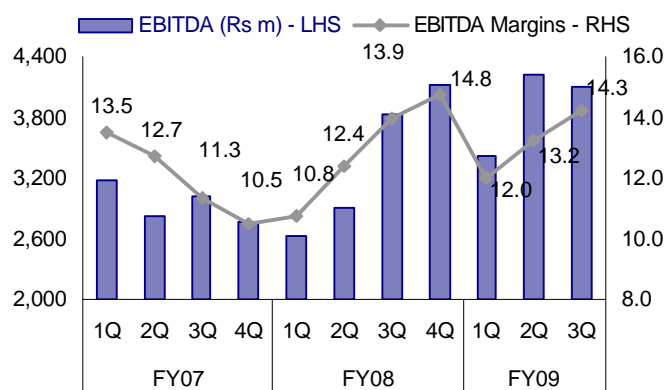
Source: Company/MOSL

EBITDA margin surprises positively

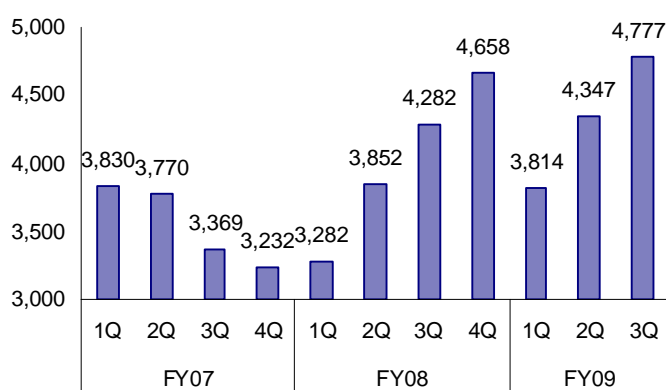
EBITDA margin expanded by 40bp YoY (~110bp QoQ) to 14.3%, aided by lower RM cost (~60bp YoY and 240bp QoQ savings) – partial reflection of lower commodity prices. Margins would have been higher but for inventory loss of Rs170-190m (~60bp impact) due to excise duty cut accounted for in 3QFY09.

Margin improvement would also be driven by increasing contribution from Haridwar plant, which contributed about 1,50,000 units in 3QFY09 (v/s 115,000 units in 2QFY09 v/s nil in 3QFY08), as well higher realizations. Lower than estimated other income at Rs508m (v/s est. Rs725m) and higher than estimated tax provisioning at 28.8% of PBT (v/s est. 26.5%) restricted PAT to Rs3b.

EBITDA MARGIN IMPROVES



TREND IN EBITDA PER UNIT (RS)

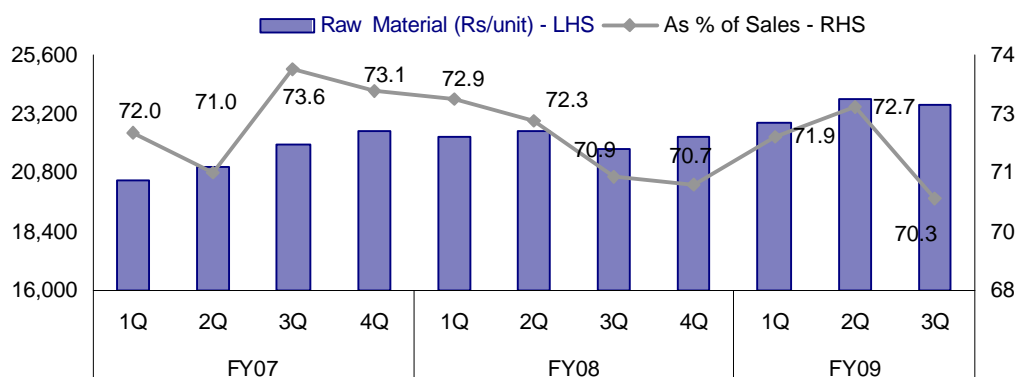


Source: Company/MOSL

Full benefit of lower commodity prices in 4QFY09

There has been decline of 240bp QoQ in RM cost driven by significant decline in commodity prices. There would be further benefits as it is yet to get benefits of certain commodities (carbon steel, alloy wheels etc) in 4QFY09. This coupled with ramp-up at Haridwar (~2,89,000 units in 4QFY09) would drive margin expansion of 100bp QoQ in 4QFY09.

RAW MATERIAL COST DECLINING



Source: Company/MOSL

Valuation and view

We have marginally revised our earnings estimates upward for FY09 by 2.4% to Rs60.9, but maintain FY10E EPS at Rs76. The change in estimates is to factor in for higher realizations and higher RM cost savings. Hero Honda offers best earnings growth visibility, driven by ramp-up at Haridwar and RM cost savings. The stock trades at 13.8x FY09 EPS and 11.1x FY10 EPS. Maintain **Buy** with target price of Rs1,060 (~14x FY10E EPS).

Hero Honda: an investment profile

Company description

Hero Honda is a JV between Honda Corporation Japan and the Munjal family with both parties owning 26% each. Hero Honda has a strong dealership network with good penetration in the rural areas as well.

Key investment arguments

- Hero Honda's substantial presence in rural India insulates it from the onslaught of competition.
- The new product launches will allow Hero Honda to maintain its leadership position, while the new plant will address capacity constraint issues.
- Hero Honda's earnings momentum is expected to continue driven by ramp-up at Haridwar plant coupled with full realization of excise benefit as more vendors set-up base at Haridwar.

Key investments risks

- There have been several new launches by competitors in the past 12 months. Hence, the competitive scenario in the country has increased, which may lead to the price wars commencing again.
- Higher interest rates have led to pressures on volumes
- The increasing commodity prices may impact EBITDA margin negatively.

Recent developments

- The company has improved its market share to 56% - its highest ever.

Valuation and view

- We expect HH to report EPS of Rs60.9 (25.6% growth) in FY09 and Rs76 (24.8% growth) in FY10.
- The stock trades at 13.8x FY09 EPS and 11.1x FY10 EPS. Maintain **Buy** with target price of Rs1,060 (~14x FY10E EPS).

Sector view

- Numerous motorcycle launches will lead to an increase in the competitive scenario
- Domestic two wheeler demand will continue to surpass estimates on the back of rural pull
- Despite the large number of players market share remains concentrated amongst the top two

COMPARATIVE VALUATIONS

		HERO HONDA	BAJAJ AUTO	TVS MOT.
P/E (x)	FY09E	13.8	7.8	22.9
	FY10E	11.1	6.2	13.4
EPS Gr (%)	FY09E	25.6	-13.4	-3.0
	FY10E	24.8	25.9	71.1
RoE (%)	FY09E	36.5	37.2	4.1
	FY10E	36.6	37.5	6.7
EV/EBITDA (x)	FY09E	8.4	4.2	10.0
	FY10E	6.4	3.0	7.4

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	60.9	62.1	-1.9
FY10	76.0	72.3	5.1

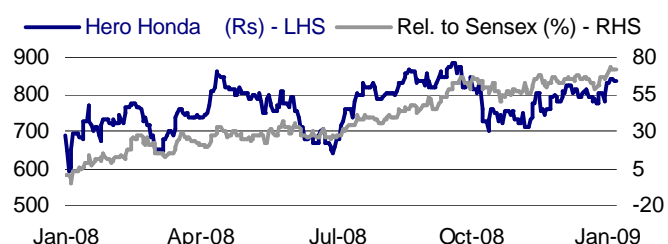
TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
834	1,060	27.1	Buy

SHAREHOLDING PATTERN (%)

	DEC-08	SEP-08	DEC-07
Promoter	55.0	55.0	55.0
Domestic Inst	11.1	13.3	8.6
Foreign	24.8	22.9	27.5
Others	9.1	8.8	9.0

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Net Sales	87,140	99,000	103,318	117,712	124,778
Change (%)	17.4	13.6	4.4	13.9	6.0
Total Income	87,140	99,000	103,318	117,712	124,778
Expenditure	73,495	87,269	89,824	101,595	105,314
EBITDA	13,645	11,730	13,494	16,118	19,464
Change (%)	16.8	-14.0	15.0	19.4	20.8
% of Net Sales	15.7	11.8	13.1	13.7	15.6
Depreciation	1,146	1,398	1,603	1,860	2,205
EBIT	12,498	10,333	11,891	14,258	17,259
Interest & Finance Charge	-61	-230	-358	-280	-280
Other Income	1,563	1,899	1,854	2,260	2,675
PBT	14,122	12,461	14,103	16,798	20,214
Tax	4,409	3,882	4,424	4,640	5,038
Effective Rate (%)	31.2	31.2	31.4	27.6	24.9
PAT	9,713	8,579	9,679	12,158	15,176
% of Net Sales	11.1	8.7	9.4	10.3	12.2
Adj. PAT	9,713	8,579	9,679	12,158	15,176
Change (%)	20.2	-11.7	12.8	25.6	24.8

BALANCE SHEET (Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
Share Capital	399	399	399	399	399
Reserves	19,694	24,301	29,463	36,364	45,699
Net Worth	20,093	24,701	29,862	36,763	46,098
Deferred Tax	1,201	1,296	1,306	1,306	1,306
Loans	1,858	1,652	1,320	1,320	1,320
Capital Employed	23,152	27,648	32,488	39,389	48,724
Gross Fixed Assets	14,720	18,006	19,388	25,973	28,473
Less: Depreciation	5,226	6,351	7,825	9,685	11,890
Net Fixed Assets	9,494	11,655	11,563	16,288	16,583
Capital WIP	442	1,899	4,085	0	0
Investments	20,619	19,739	25,668	25,668	25,668
Curr.Assets, L & Adv	8,212	9,133	9,368	17,593	27,701
Inventory	2,266	2,756	3,171	3,547	3,760
Sundry Debtors	1,587	3,353	2,974	3,547	3,760
Cash & Bank Balances	1,587	358	1,311	8,587	18,269
Loans & Advances	2,738	2,631	1,855	1,855	1,855
Current Liab. & Prov.	15,628	14,792	18,247	20,212	21,280
Sundry Creditors	6,344	5,511	7,561	8,062	8,546
Other Liabilities	4,385	4,909	5,689	5,689	5,689
Provisions	4,899	4,372	4,998	6,461	7,045
Net Current Assets	-7,416	-5,659	-8,880	-2,619	6,421
Application of Funds	23,152	27,648	32,488	39,389	48,724

E: MOSL Estimates

RATIOS					
Y/E MARCH	2006	2007	2008	2009E	2010E
Basic (Rs)					
EPS	48.6	43.0	48.5	60.9	76.0
EPS growth (%)	20.2	-11.7	12.8	25.6	24.8
Cash EPS	54.4	50.0	56.5	70.2	87.0
Book Value per Share	100.6	123.7	149.5	184.1	230.8
DPS	20.0	17.0	19.0	22.5	25.0
Payout (Incl. Div. Tax) %	46.3	46.3	45.9	43.2	38.5
Valuation (x)					
P/E		19.6	17.4	13.8	11.1
Cash P/E		16.8	14.9	12.0	9.7
EV/EBITDA		12.7	10.5	8.4	6.4
EV/Sales		15	14	11	10
Price to Book Value		6.8	5.6	4.6	3.6
Dividend Yield (%)		2.0	2.3	2.7	3.0
Profitability Ratios (%)					
RoE	55.5	38.3	35.5	36.5	36.6
RoCE	68.4	48.2	45.7	46.0	45.2
Turnover Ratios					
Debtors (Days)	7	12	11	11	11
Asset Turnover (x)	3.8	3.6	3.2	3.0	2.6
Leverage Ratio					
Debt/Equity (x)	0.1	0.1	0.0	0.0	0.0

CASH FLOW STATEMENT (Rs Million)					
Y/E MARCH	2006	2007	2008	2009E	2010E
OP/(Loss) before Tax	12,498	10,333	11,891	14,258	17,259
Interest/Div. Received	1,563	1,899	1,854	2,260	2,675
Depreciation & Amort.	1,146	1,398	1,603	1,860	2,205
Direct Taxes Paid	-4,223	-3,787	-4,414	-4,640	-5,038
(Inc)/Dec in Working Capi	-633	-3,146	4,174	1,015	642
Other Items	-7	-1	-38	0	0
CF from Oper. Activi	10,345	6,695	15,069	14,753	17,743
(Inc)/Dec in FA+CWIP	-3,929	-5,017	-3,696	-2,500	-2,500
(Pur)/Sale of Invest.	-352	880	-5,930	0	0
CF from Inv. Activity	-4,281	-4,137	-9,626	-2,500	-2,500
Changes in Reserves	-560	-577	-723	-764	-849
Inc/(Dec) in Debt	-160	-206	-332	0	0
Interest Paid	61	230	358	280	280
Dividends Paid	-3,994	-3,395	-3,794	-4,493	-4,993
CF from Fin. Activity	-4,652	-3,948	-4,491	-4,977	-5,561
Inc/(Dec) in Cash	1,411	-1,389	953	7,276	9,682
Add: Beginning Balance	176	1,587	358	1,311	8,587
Closing Balance	1,587	198	1,311	8,587	18,269

N O T E S



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Hero Honda Motors

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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