

## Company

1 September 2009 | 7 pages

# Hero Honda (HROH.BO)

Equity

## Aug09 Sales – In Line With Expectations

- **Aug09 volume growth was strong** — +c36%Y/Y – but in the midpoint of the 'whisper estimates' of 410-425,000 units. Of this demand, around 60-70k units is pipeline stocking in anticipation of the festive season from end Sept/Oct. Retail demand figures are yet unavailable, but mgmt expects they would have been slightly ahead of July's retail sales of 340,000 units
- **FY10 guidance marginally revised upwards** — to the 10-12% range, from 8-10% earlier. Based on the current trend, HH appears to be comfortably on course for achieving targeted growth. We expect it to fine-tune its guidance over the next month and into the festive season.
- **No monsoon impact – as yet** — Mgmt noted that the monsoon impact has yet to be seen. Mgmt expects sales growth to slacken after the monsoons, especially if the winter rains are lackluster (which could impact sentiment).
- **Product launches across 3/4Q** — Hero Honda is to launch a slew of products – mainly upgrades - of the existing models over 3/4Q.
- **Competitive intensity remains muted** — in the motorcycle industry. Mgmt stated that there are virtually no discounts in the marketplace, and it does not expect discounts to revive in the festive season, which augurs well for overall profitability of the industry.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (01 Sep 09)	Rs1,534.75
Target price	Rs1,593.00
Expected share price return	3.8%
Expected dividend yield	1.6%
<b>Expected total return</b>	<b>5.4%</b>
Market Cap	Rs306,470M
	US\$6,294M

### Price Performance (RIC: HROH.BO, BB: HH IN)



Figure 1. Hero Honda: Aug09 Sales

	August Sales (Nos)	YoY Chg (%)	MoM chg (%)	YTD Sales (Nos)	YoY chg (%)
Two Wheelers	415,137	35.9	13.2	1,900,932	28.3

Source: Company Reports

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
<b>Valuation Ratios</b>					
P/E adjusted (x)	35.7	31.7	23.9	16.5	14.5
EV/EBITDA adjusted (x)	24.5	21.1	16.2	11.2	9.3
P/BV (x)	12.4	10.3	8.1	6.0	4.3
Dividend yield (%)	1.1	1.2	1.3	1.6	1.9
<b>Per Share Data (Rs)</b>					
EPS adjusted	42.96	48.47	64.19	93.08	106.05
EPS reported	42.96	48.47	64.19	93.08	106.05
BVPS	123.69	149.54	190.42	254.38	360.43
DPS	17.00	19.00	20.00	25.00	29.00
<b>Profit &amp; Loss (RsM)</b>					
Net sales	99,000	103,318	123,191	142,054	159,186
Operating expenses	-88,667	-91,428	-107,880	-120,285	-134,123
<b>EBIT</b>	<b>10,333</b>	<b>11,891</b>	<b>15,311</b>	<b>21,769</b>	<b>25,063</b>
Net interest expense	-16	-20	-20	-25	-30
Non-operating/exceptionals	2,145	2,232	2,524	2,714	2,834
<b>Pre-tax profit</b>	<b>12,461</b>	<b>14,103</b>	<b>17,815</b>	<b>24,458</b>	<b>27,867</b>
Tax	-3,882	-4,424	-4,997	-5,870	-6,688
Extraord./Min.Int./Pref.div.	0	0	0	0	0
<b>Reported net income</b>	<b>8,579</b>	<b>9,679</b>	<b>12,818</b>	<b>18,588</b>	<b>21,179</b>
Adjusted earnings	8,579	9,679	12,818	18,588	21,179
Adjusted EBITDA	11,730	13,494	17,118	23,692	26,997
<b>Growth Rates (%)</b>					
Sales	13.6	4.4	19.2	15.3	12.1
EBIT adjusted	-17.3	15.1	28.8	42.2	15.1
EBITDA adjusted	-14.0	15.0	26.9	38.4	13.9
EPS adjusted	-11.7	12.8	32.4	45.0	13.9
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>7,517</b>	<b>14,888</b>	<b>12,551</b>	<b>19,933</b>	<b>23,301</b>
Depreciation/amortization	1,398	1,603	1,807	1,923	1,934
Net working capital	-2,459	3,606	-2,074	-578	188
<b>Investing cash flow</b>	<b>-4,514</b>	<b>-10,419</b>	<b>-10,387</b>	<b>-16,345</b>	<b>-18,389</b>
Capital expenditure	-4,744	-3,407	0	-3,000	-1,000
Acquisitions/disposals	880	-6,131	-9,582	-12,439	-16,484
<b>Financing cash flow</b>	<b>-4,178</b>	<b>-4,771</b>	<b>-3,973</b>	<b>-5,616</b>	<b>0</b>
Borrowings	-206	-332	680	200	0
Dividends paid	-3,972	-4,439	-4,653	-5,816	0
<b>Change in cash</b>	<b>-1,174</b>	<b>-302</b>	<b>-1,809</b>	<b>-2,028</b>	<b>4,912</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>42,426</b>	<b>50,668</b>	<b>59,793</b>	<b>74,483</b>	<b>90,830</b>
Cash & cash equivalent	358	1,311	500	600	600
Accounts receivable	3,353	2,974	3,339	3,737	4,165
Net fixed assets	13,555	15,487	13,680	14,758	13,825
<b>Total liabilities</b>	<b>17,739</b>	<b>20,805</b>	<b>21,766</b>	<b>23,683</b>	<b>18,852</b>
Accounts payable	5,548	7,561	8,137	8,431	9,416
Total Debt	1,652	1,320	2,000	2,200	2,200
<b>Shareholders' funds</b>	<b>24,701</b>	<b>29,862</b>	<b>38,027</b>	<b>50,799</b>	<b>71,978</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	11.8	13.1	13.9	16.7	17.0
ROE adjusted	38.3	35.5	37.8	41.9	34.5
ROIC adjusted	152.3	116.3	193.4	nm	nm
Net debt to equity	5.2	0.0	3.9	3.1	2.2
Total debt to capital	6.3	4.2	5.0	4.2	3.0

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## Hero Honda

### Company description

Hero Honda is India's largest manufacturer of two-wheelers. The company has benefited from the demand shift to motorcycles, as it focuses solely on this product segment. It has a strong product portfolio, and received technology and brand support from Honda Motors, Japan. With fuel efficiency and riding comfort as the main selling points, management has been able to address a wide market and post robust sales growth.

### Investment strategy

We rate Hero Honda shares Buy/Low Risk (1L) with a target price of Rs1,593. We believe Hero Honda will retain its competitive advantage in a challenging operating environment given its superior strategy, significant fiscal incentives and lower dependence on financing. We forecast a strong 29% earnings CAGR for Hero Honda over FY09-FY11E driven by a richer product mix and fiscal incentives at its Uttaranchal plant. We forecast 26% growth in EBITDA (core operating profits) over FY09-11E. The growth outlook for two-wheelers remains stable over the next two years, in our view. The vehicle financing cycle is incrementally improving, which augurs well for the volume outlook for both Hero Honda and its competition. Structural growth drivers - viz. the lack of adequate public transportation, a burgeoning population, rising income levels - are all structural growth drivers which should remain intact over the long term.

### Valuation

Our target price of Rs1,593 is based on 16x Sep 10E earnings, which we believe is well supported by a robust earnings CAGR of 29% over FY09-11E. While this is to a certain extent driven by tax breaks at the Uttaranchal facility, we derive comfort from our expectations that core EBITDA (operating profits) will grow at 26% CAGR over the same period. Our target multiple of 16x is at a 20% premium to HH's 5-year P/E multiple of 13.3x, which we think is justified given Hero Honda's earnings CAGR of 29% over FY09-11E. We have chosen to use the P/E valuation metric to value Hero Honda, given the company's high level of cash generation, reflecting its strong balance sheet (around Rs35bn in cash and cash equivalents).

### Risks

We rate Hero Honda Low Risk according to our quantitative risk rating system, which tracks 260-day historical share price volatility. The key downside risks that could impede the stock from reaching our target price are: 1) Slower-than-forecast growth in the two-wheeler industry, 2) Any substantial increase in interest rates and greater than forecast increase in material costs. Upside risks to our target price include: 1) lower-than-forecast increase in material costs and volumes; 2) lower-than-expected competitive intensity.

# Appendix A-1

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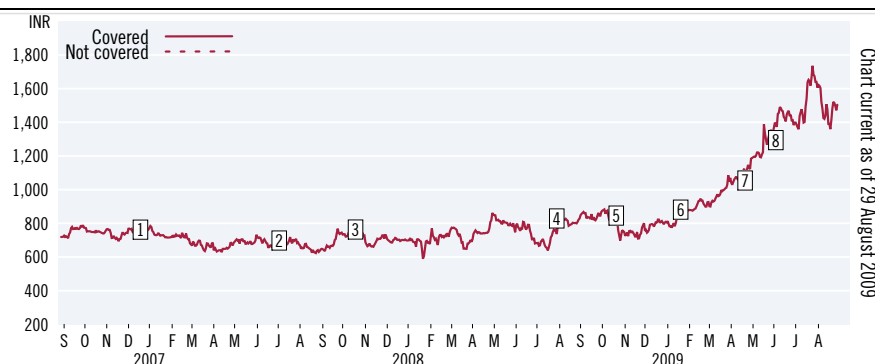
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### Hero Honda (HROH.BO)

#### Ratings and Target Price History

#### Fundamental Research

Analyst: Jamshed Dadabhyoy



	Date	Rating	Target Price	Closing Price
1	19-Dec-06	3L	*678.00	752.80
2	3-Jul-07	3L	*655.00	688.55
3	18-Oct-07	3L	*670.00	724.60

	Date	Rating	Target Price	Closing Price
4	29-Jul-08	*2L	*764.00	736.15
5	21-Oct-08	2L	*867.00	826.15
6	20-Jan-09	2L	*931.00	834.05

	Date	Rating	Target Price	Closing Price
7	21-Apr-09	*1L	*1,258.00	1,100.90
8	3-Jun-09	1L	*1,593.00	1,392.05

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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