

Sector: Auto

Target Price	Rs900
Market cap (bn)	Rs146/US\$3
52-week range	Rs970/537
Shares in issue (mn)	199.7
6-mon avg daily vol (no of shares)	295,264
6-mon avg daily vol (mn)	Rs216.4/US\$4.7
Bloomberg	HHIN
Reuters	HROHBO
BSE Sensex	10119
Website:	www.herohonda.com

Shareholding Pattern (%)

Promoters	55.0
FII	26.7
FI/MF	8.3
Public	9.4
Others	0.7

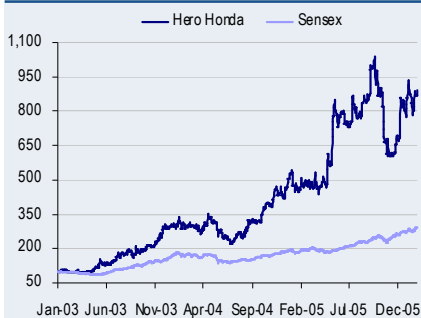
(As of 31 March 2006)

Price Performance (%)

	1M	3M	12M
Absolute	(13.2)	(17.3)	32.5
Relative*	1.4	(14.9)	(18.1)

* To the BSE Sensex

Relative Performance



(As of 30 May 2006)

Analysts:

Kalpesh Parekh

kparekh@askrj.net

Tel: (91 22) 6646 0017

Amita Sengupta

asengupta@askrj.net

Tel: (91 22) 6646 0018

Viraaj Teckchandani

vteckchandani@askrj.net

Tel: (91 22) 6646 0019

Back in action

Hero Honda reported a better-than-expected 29% growth in PAT during 4Q FY06 results. The company is making strong moves in maintaining the market share and will be launching eight new motorcycle models spread across the segments. This move would be first of its kind in the industry where a company is launching so many new products in a single year to take on competition.

Further, the company has also resolved the uncertainty related to capacity constraints for the next few years by going ahead with brown field and greenfield expansion.

The stock price has corrected by more than 15% in the last three months, as the company was unable to show the required growth. We believe that the company can easily grow in line or better than the industry growth of 15%. We expect Hero Honda to report an EPS of Rs54 for FY07 and Rs60 for FY08. At a PE of 12.3x for FY08, we believe that the stock is very attractive and will offer more than 20% upside from current levels. We are upgrading the stock from Hold to Buy with the price target of Rs900 from 1-year perspective.

Highlights

- Topline driven by volume growth:** Hero Honda reported a 16.3% YoY topline growth for 4Q FY06 led by a 12.7% growth in volumes. The value growth was on account of improving product mix. Operating margin improved by 100 bps to 16.1% during the quarter. OPM expansion was on account of the company's policy change during third quarter to buy out dies and moulds on behalf of vendors and thus lower raw material costs. Adjusted net profit grew 29% YoY for the quarter and 18% YoY for FY06.

Exhibit 1: Key financials

(Rs mn)

Y/E March	FY04	FY05	FY06E	FY07E	FY08E
Total Income	58,324	74,217	87,140	102,415	116,999
Operating Profit	9,794	11,645	13,680	15,600	17,458
OPM (%)	16.8	15.7	15.7	15.2	14.9
Net Profit	7,283	8,216	9,713	10,819	11,946
EPS (Rs)	36.5	41.1	48.6	54.2	59.8
EPS Growth (%)	25.4	12.8	18.2	11.4	10.4
RONW (%)	64.0	57.9	49.8	43.8	39.3
ROCE (%)	76.4	68.4	58.7	51.8	46.6
PE (x)	20.1	17.8	15.1	13.5	12.3
PEG (x)	0.8	1.4	0.8	1.2	1.2
EV/EBID TA (x)	13.4	10.9	9.0	7.6	6.5

Source: Company, ASK Raymond James. Note: Valuations as of 30 May 2006.

- **Plans to launch eight new models in this fiscal:** We believe that the company has realised that it would lose out on the market share unless it soon launches stylish new products and price and position them properly. Hence, Hero Honda has announced its plans of launching 8 new products during this fiscal, which includes four new models and four variants. We believe this move would be first of its kind in the industry. Though we do not expect 100% success ratio for the same, even if one new model is successful, we believe there exists a higher possibility of the company growing at above 15% YoY. We understand that they are internally targeting sales of around 3.6 mn units, growth of 20% YoY.
- **Hondas commitment is on:** During the press meet, the company's management announced its plans to launch India's first motorcycle with Fuel Injection (FI) technology in June 2006, with the launch of 125 cc Glamour FI. We understand that this is the first time that Honda Motor Company will debut this technology globally in the 125 cc category and that too through Hero Honda, which indicates Honda's strong commitment towards the company. We view this positively as such a commitment was not visible from Honda in the last few years.
- **Margin pressure, not to worry:** We understand that the company is planning to aggressively price the model (Glamour FI) to gain the lost market share and maintain its dominance in the motorcycle industry. This will put some pressure on margins, but overall we expect volume gains to offset the margin pressure. In our assumptions, we have still factored in 50 bps contraction in margins during FY07 to 15.2% and 30 bps during FY08 to 14.9%.
- **Resolving capacity constraint issue:** The company has ramped up the capacity at its existing facility at Gurgaon and Dharuhera by around 450,000 units, thereby raising the total capacity to around 3.9 mn units. The company also announced that its third plant with capacity of 500,000 units would be set-up in Jaipur and Rajasthan, with capex plan of around Rs3.2 bn. Further, the plant can be easily ramped up to 1 mn units with minimal capex. We believe that the company has resolved the uncertainty related to capacity constraint for the next few years and should now concentrate on marketing.
- **Upgrading to Buy, with target price of Rs900:** The stock price has corrected by more than 15% in the last three months as the company was unable to report the required growth in the absence of new models. The company was highly depended on its ace product Splendour. With plans of launching 8 new products in less than a years time, we believe that the company can easily grow in line or better than the industry growth of 15%. We expect Hero Honda to report an EPS of Rs54 for YF07 and Rs60 for FY08. At a PE of 12.3x for FY08E, we believe that the stock is very attractive and will offer around 18-20% upside from current levels. We are upgrading the stock from Hold to Buy with the price target of Rs900 from 1-year perspective.

Exhibit 2: Results review

(Rs mn)

Y/E March	4Q			Full year		
	FY05	FY06E	% chg	FY05	FY06	% chg
Sales Turnover	19,403	22,559	16.3	74,217	87,140	17.4
Total Exp.	16,471	18,927	14.9	62,571	73,460	17.4
Raw Material Cost	13,635	15,394	12.9	51,996	60,523	16.4
Staff cost	729	821	12.6	2,680	3,206	19.6
Other Exp.	2,107	2,711	28.7	7,895	9,731	23.2
Operating Profit	2,932	3,632	23.9	11,645	13,680	17.5
Interest	-4	-39	793.2	(11)	(61)	457.3
Depreciation	264	305	15.6	894	1,146	28.2
PBT before other income	2,673	3,367	25.9	10,763	12,595	17.0
Other Income	358	430	20.3	1,520	1,527	0.5
PBT	3,031	3,797	25.3	12,283	14,122	15.0
Tax	960	1,125	17.2	4,068	4,409	8.4
Adjusted PAT	2,071	2,672	29.0	8,215	9,713	18.2
Reported PAT	2,071	2,672	29.0	8,216	9,713	18.2
Key Ratios						
Raw Material Cost	70.3	68.2		70.1	69.5	
Staff Cost	3.8	3.6		3.6	3.7	
Other Expense	10.9	12.0		10.6	11.2	
Operating profit	15.1	16.1		15.7	15.7	
Net Profit	10.7	11.8		11.1	11.1	
Effective tax rate (Tax/PBT)	31.7	29.6		33.1	31.2	
Adjusted EPS (Rs)	10.4	13.4		41.1	48.6	
CEPS	11.7	14.9		45.6	54.3	

Source: Company data, ASK Raymond James.

Dealing / Sales Contacts

Bhavesh Jangla	(91 22) 2498 5680/90	bjangla@askrj.net	Pankti Bhansali	(91 22) 6646 0052	pbhansali@askrj.net
Mrunal Shah	(91 22) 2498 5680/90	mshah@askrj.net	Vinay Goel (F&O)	(91 22) 2498 5680/90	vgoel@askrj.net
Amit Shah	(91 22) 2498 5680/90	ashah@askrj.net			

**ASK-RAYMOND JAMES****& ASSOCIATES PRIVATE LIMITED****MEMBER, BOMBAY AND NATIONAL STOCK EXCHANGES**

Bandbox House (Rear), 1st Floor, 254-D, Dr Annie Besant Road, Worli, Mumbai 400 025
 Tel: +91 22 6646 0000 • Dealers: +91 22 2498 5680/90 • Fax: +91 22 2498 5666
 Email: broking@askrj.net

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