

In line with expectations

 22nd October 2008

BUY

Price	Target Price
Rs 826	Rs 1028

Sensex 10,683

Price Performance

(%)	1M	3M	6M	12M
Absolute	1	15	11	9
Rel. to Sensex	32	49	75	80

Source: Bloomberg

Stock Details

Sector	Automobiles
Reuters	HROH.BO
Bloomberg	HH@IN
Equity Capital (Rs mn)	399
Face Value (Rs)	2
No of shares o/s (mn)	200
52 Week H/L (Rs)	895/561
Market Cap (Rs bn/USD mn)	165/3,361
Daily Avg Vol (No of shares)	515947
Daily Avg Turnover (US\$ mn)	8.7

Shareholding Pattern (%)

	30/09/08	30/06/08	31/03/08
Promoters	55.0	55.0	55.0
FII/NRI	22.9	24.3	24.7
Institutions	13.3	12.0	11.5
Private Corp	0.9	0.8	0.7
Public	8.0	8.0	8.1

Source: Capitaline

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Hero Honda's 2QFY09 numbers were in line with our expectations. While net sales at Rs 32 bn (YoY growth of 36%) were in line with our estimates, EBIDTA at Rs 4.4 bn (YoY growth of 49%) was ahead of our expectations by around 4%. However, significantly higher tax provision (2QFY09 tax rate was 32% against our expectation of 24%), resulted in net profits of Rs 3.1 bn (YoY growth of 51%), was below of our expectation by 2%. The higher tax rate is due to reduction in target production at Haridwar plant from 750,000 to 600,000 units

1HFY09 performance, the required residual growth in FY09 and the declining raw material prices, warrants volumes/earnings upgrade in FY09 as well as FY10. However, considering the cautious stand adopted by the management, we are leaving our estimates unchanged currently.

At Rs 826, the stock trades at PER of 13.6x and 11.7x our FY09 and FY10 EPS estimates of Rs 60.6 and Rs 70.8 respectively. We maintain our BUY rating on the stock.

Volumes and pricing led topline growth

Net sales grew by 36% YoY to 32 bn lead by volumes growth by 28.4% YoY to 971,579 units, pricing action of around 4% and improving product mix. Average realization stood at Rs 32,597, YoY increase of 6%.

Product mix %	2QFY09	2QFY08	1QFY09	Product mix %	2QFY09	2QFY08	1QFY09
Motorcycles	96.2	96.0	97.2	Motorcycles (Domestic)			
Scooters	3.8	4.0	2.8	upto 125cc	95.1	96.0	93.0
Total	100.0	100.0	100.0	125cc to 250 cc	4.9	4.0	7.0
				Motorcycles (Exports)			
Exports	2.6	2.7	1.9	upto 125cc	90.7	92.9	86.3
Domestic	97.4	97.3	98.1	125cc to 250 cc	9.3	7.1	13.7

47% YoY increase in tax expense restricts the benefits of strong operating performance

The company reported an EBIDTA of Rs 4.4 bn, outperforming our estimates by around 4%. However, a 47% YoY increase tax provision to Rs 1.4 bn, resulted in net profit growth at 51% to Rs 3.1 bn, slightly below our expectation. This is despite a 37% YoY increase in other income to Rs 539 mn. *The higher tax provision is due to reduction in target production at Haridwar plant from 750,000 to 600,000 units. However, there is no change in the overall estimated target sales of the company for the year.*

Valuation and View

1HFY09 performance, the required residual performance in FY09 and the declining raw material prices, warrants volumes/earnings upgrade in FY09 as well as FY10. However, considering the cautious stand adopted by the management, we are leaving our estimates unchanged currently

At Rs 826, the stock trades at PER of 13.6x and 11.7x our FY09 and FY10 EPS estimates of Rs 60.6 and Rs 70.8 respectively. We maintain our BUY rating on the stock.

Quarterly Results summary

Rs mn	2QFY08	2QFY09	% change	1HFY08	1HFY09	% change
Net Sales	23,521	32,020	36.1	48,001	60,455	25.9
Operating Expenses						
Raw Materials	17,013	23,183	36.3	34,860	43,637	25.2
<i>% of Sales</i>	72.3	72.4		72.6	72.2	
Staff Costs	870	1,103	26.7	1,837	2,142	16.6
<i>% of Sales</i>	3.7	3.4		3.8	3.5	
Other Expenses	2,724	3,386	24.3	5,755	6,918	20.2
<i>% of Sales</i>	11.6	10.6		12.0	11.4	
EBIDTA	2,915	4,348	49.2	5,549	7,759	39.8
EBIDTA %	12.4	13.6		11.6	12.8	
<i>Forex gain/(loss)</i>	0.0	0.0		0.0	0.0	
Adj EBIDTA	2,915	4,348	49.2	5,549	7,759	39.8
ADJ EBIDTA %	12.4	13.6		11.6	12.8	
Depreciation	384	466	21.3	760	888	16.8
EBIT	2,530	3,882	53.4	4,789	6,870	43.5
Other Income	393	539	37.2	782	1,006	28.7
Interest	(90)	(83)	(6.8)	(179)	(133)	(25.6)
PBT	3,012	4,504	49.5	5,750	8,010	39.3
<i>Extraordinary inc/(exp)</i>	0.0	0.0		0.0	0.0	
Tax	980	1,442	47.1	1,819	2,218	21.9
Net Profit	2,032	3,063	50.7	3,930	5,791	47.3
<i>Net Margin %</i>	8.6	9.6		8.2	9.6	
Adjusted Net Profit	2,032	3,063	50.7	3,930	5,791	47.3
<i>Adjusted Net Margin %</i>	8.6	9.6		8.2	9.6	
EPS	10.2	15.3	50.7	19.7	29.0	47.3
Adjusted EPS	10.2	15.3	50.7	19.7	29.0	47.3

Profit & Loss Account

Mar ending (Rs mn)	FY07	FY08	FY09E	FY10E
Net Sales	99,000	103,318	119,062	135,734
Growth %	13.6	4.4	15.2	14.0
Operating Expenses				
Raw Materials	71,787	74,025	84,772	96,779
% of Sales	72.5	71.6	71.2	71.3
Staff Costs	3,538	3,835	4,343	4,961
% of Sales	3.6	3.7	3.6	3.7
Other Expenses	11,944	11,964	14,049	16,288
% of Sales	12.1	11.6	11.8	12.0
EBIDTA	11,730	13,494	15,898	17,706
Growth %	(14.0)	15.0	17.8	11.4
EBIDTA %	11.8	13.1	13.4	13.0
Other Income	2,145	2,231	2,605	2,710
Interest	16	20	13	10
PBDT	13,859	15,705	18,490	20,406
Depreciation	1,398	1,603	1,791	2,056
PBT	12,461	14,102	16,699	18,349
Extraordinary inc/(exp)	0	0	0	0
Tax	3,882	4,424	4,592	4,220
Net Profit	8,579	9,678	12,107	14,129
Net Margin %	8.7	9.4	10.2	10.4
Growth %	(11.7)	12.8	25.1	16.7
EPS	43.0	48.5	60.6	70.8
CEPS	50.0	56.5	69.6	81.1

Cash Flow

Mar ending (Rs mn)	FY07	FY08	FY09E	FY10E
Net Profit before tax	12,461	14,102	16,699	18,349
Add: Depreciation	1,398	1,603	1,791	2,056
Add: Interest	16	20	13	10
Less: Other income	2,145	2,231	2,605	2,710
Other non operating items	(24)			
(Dec)/Inc in Working capital	1,654	(4,195)	6,197	(638)
Less: Tax paid	3,802	4,424	4,592	4,220
Cash from operations	6,251	13,265	5,109	14,124
Capex	(5,229)	(3,567)	585	(3,000)
Investments and others	353	(5,930)	(2,000)	(2,000)
Other income	2,145	2,231	2,605	2,710
Cash from Investing activities	(2,731)	(7,265)	1,190	(2,290)
Borrowings	(177)	(332)	(200)	(200)
Interest paid	(45)	(20)	(13)	(10)
Dividend paid	(4,521)	(4,416)	(5,949)	(6,943)
Cash from financing activities	(4,743)	(4,768)	(6,162)	(7,153)
Cash generation during the year	(1,224)	1,232	137	4,681
Opening Balance	1,587	358	1,311	1,448
Closing Balance*	363	1,589	1,448	6,129

Balance Sheet

Mar ending (Rs mn)	FY07	FY08	FY09E	FY10E
Share Capital	399	399	399	399
Reserves	24,301	29,463	35,621	42,807
Misc Exp	0	0	0	0
Owned Funds	24,701	29,862	36,020	43,207
Secured Loans	0	0	0	0
Unsecured Loans	1,652	1,320	1,120	920
Loan Funds	1,652	1,320	1,120	920
Deferred Tax Liability	1,282	1,254	1,254	1,254
Total	27,634	32,436	38,394	45,380
Gross Fixed Assets	18,006	19,388	22,388	25,388
Acc. Depreciation	6,351	7,825	9,616	11,673
Net Fixed Assets	11,655	11,563	12,772	13,715
Capital WIP	1,899	4,085	500	500
Net Block	13,555	15,648	13,272	14,215
Investments	19,739	25,668	27,668	29,668
Sundry Debtors	3,353	2,974	4,846	5,525
Inventory	2,756	3,171	4,474	5,100
Cash & Bank	358	1,311	1,448	6,129
Advances	2,631	1,855	4,167	4,751
Other Current Assets	36	57	57	57
Current Assets	9,133	9,368	14,992	21,562
Liabilities	10,419	13,250	11,023	12,611
Provisions	4,372	4,998	6,515	7,454
Current Liabilities	14,792	18,247	17,538	20,065
Net Current Assets	(5,659)	(8,880)	(2,546)	1,497
Total	27,634	32,436	38,394	45,380

Ratios

Mar ending (Rs mn)	FY07	FY08	FY09E	FY10E
Per Share Data				
EPS	43.0	48.5	60.6	70.8
Cash EPS	50.0	56.5	69.6	81.1
BVPS	123.7	149.5	180.4	216.4
Valuation ratio				
P/E	19.2	17.0	13.6	11.7
Cash P/E	16.5	14.6	11.9	10.2
P/BV	6.7	5.5	4.6	3.8
EV/EBIDTA	12.5	10.3	8.6	7.3
Return Ratios (%)				
AROE	38.3	35.5	36.8	35.7
AROCE	40.7	39.6	39.8	37.4
Dupont				
NPM (%)	8.7	9.4	10.2	10.4
Sales/TA	2.3	2.0	2.1	2.1
TA/Equity	1.7	1.7	1.6	1.5
Other key ratios				
D/E	0.1	0.0	0.0	0.0
NWC/Sales (%)	(6.1)	(9.9)	(3.4)	(3.4)

* FY07 closing balance includes exchange gain of Rs 5.2 m and hence there will be a difference with the balance sheet figures

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