

Share Data

Reuters code	HROH.BO
Bloomberg code	HH IN
Market cap. (US\$ mn)	8,197
6M avg. daily turnover (US\$ mn)	20.7
Issued shares (mn)	200
Target price (Rs)	1,819

Performance (%)	1M	3M	12M
Absolute	2	1	32
Relative	3	4	17

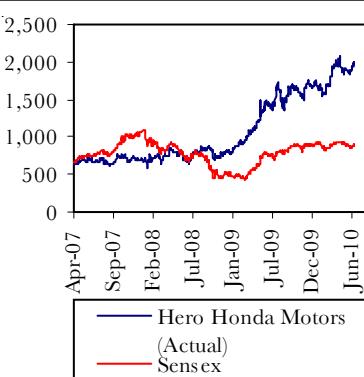
Valuation Ratios

Yr to 31 Mar	FY11E	FY12E
EPS (Rs)	121.3	137.5
+/- (%)	8.5	13.3
PER (x)	15.9	14.0
PBV (x)	7.4	5.3
Dividend/Yield (%)	1.6	1.6
EV/Sales (x)	1.9	1.6
EV/EBITDA (x)	11.3	9.9

Major shareholders (%)

Promoters	55
FIIs	30
MFs	2
BFSI's	5
Public & Others	8

Relative performance



Hero Honda Motors

Maintain Outperformer

Price: Rs 1,931

BSE Index: 16,658

09 June 2010

Demand momentum strong!

We met Hero Honda (HH) management and came back positive on continued strong demand momentum in the two-wheeler space. Key takeaways from the meeting:

- The management sees strong demand momentum in the two-wheeler space to continue, led by normal monsoon, new launches, and finance availability. HH's dealer inventory levels have actually declined in May 2010 and management expects them to remain at reasonable levels (~30 days) for the company and industry.
- Ramp up at the Haridwar plant is on track (the plant currently operates at 75% capacity and produces Splendor and Passion) and will reach full capacity by FY11-end. Localization level at Haridwar is at 60-70% and the company plans to increase this to 80% in a phased manner.
- Management is not too perturbed with market share loss in recent months and will be launching nine new models/variants across segments (mostly motorcycles) in the next 12 months, to leverage on the strong demand scenario. We believe this should help HH in containing loss of market share to a great extent.
- Supply side issues (batteries) have been sorted out for now. All of HH's vehicles are BSIII compliant and dispatches of the BSIII-compliant Splendor + has started in the past 15 days.
- The company is offering no subventions/discounts at present since demand is strong.
- It expects pricing power to remain strong and it does not expect price wars in the foreseeable future, which is evident from the recent price increase of Rs 500-1,000 on HH models to recover increased costs from emission norms and feature upgrades.
- For raw material, HH has started entering into three-month contracts considering high price volatility. It expects the recent slide in commodity prices to help in the next round of negotiations (last negotiation was in March 2010) and partially reduce margin pressure.
- Export realizations and margins are similar to domestic ones, after taking into account exports incentives.
- Capex for FY11 would be Rs 3-4 bn comprising ramping up capacity at Haridwar and maintenance capex.
- Cash on books stands at Rs 42 bn as on March 2010; the company is virtually debt free with negative working capital.
- HH's finance penetration is at 15% vis-à-vis 25-30% for the industry and its share of rural sales is at 45%.

B&K View

We expect HH to increase volumes by 11.2% to 5.1 mn (4.8 mn motorcycles and 0.3 mn scooters) in FY11 slightly below 12-15% growth expected in industry volumes. This would result in marginal loss of market share (against significant dip to 53.9% in March 2010 from 63.1% in March 2009). Strong demand momentum, coupled with reasonably strong pricing power and increased share of production from Haridwar, would enable healthy EBITDA margin at 16.5%. We have revised our earnings estimates upward by 1% for FY11E and by 5.3% for FY12E predicated on these assumptions. We expect HH to continue with its market leadership over the medium term. The stock currently trades at 15.9x FY11E earnings and 14x FY12E earnings. We maintain our Outperformer rating on the stock.

Revised assumptions

(units)	Revised			Earlier		
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E
Total volumes	4,600,130	5,113,711	5,639,545	4,600,130	5,070,857	5,481,453
YoY (%)	23.6	11.2	10.3	23.6	10.2	8.1
Realisation (Rs)	34,415	35,220	36,107	34,415	35,055	35,717
YoY %	4.0	2.3	2.5	4.0	1.9	1.9
EBITDA margins (%)	17.5	16.5	16.6	17.5	16.5	16.3
EPS (Rs)	111.8	121.3	137.5	111.8	120.1	130.6
YoY (%)	74.1	8.5	13.3	74.1	7.5	8.7

Income Statement

Yr end 31 Mar (Rs mn)	FY09	FY10E	FY11E	FY12E
Net sales	123,191	158,312	180,105	203,626
Growth (%)	19.2	28.5	13.8	13.1
Operating expenses	(105,901)	(130,643)	(150,463)	(169,847)
Operating profit	17,291	27,670	29,642	33,778
EBITDA	17,291	27,670	29,642	33,778
Growth (%)	27.7	60.0	7.1	14.0
Depreciation	(1,807)	(1,915)	(2,180)	(2,442)
Other income	2,356	2,592	2,648	2,785
EBIT	17,840	28,347	30,109	34,121
Interest paid	(25)	(30)	(20)	(20)
Pre-tax profit	17,815	28,317	30,089	34,101
(before non-recurring)				
Pre-tax profit	17,815	28,317	30,089	34,101
(after non-recurring)				
Tax (current + deferred)	(4,997)	(5,999)	(5,867)	(6,650)
Net profit (before Minority)	12,818	22,318	24,222	27,452
Interest, Pref. Dividend, etc.)				
Reported PAT	12,818	22,318	24,222	27,452
Adjusted net profit	12,818	22,318	24,222	27,452
Growth (%)	32.6	74.1	8.5	13.3

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY09	FY10E	FY11E	FY12E
Pre-tax profit	17,815	28,317	30,089	34,101
Depreciation	1,807	1,915	2,180	2,442
Change in working capital	2,224	(2,726)	1,076	660
Total tax paid	(4,866)	(5,818)	(5,717)	(6,501)
Cash flow from oper. (a)	16,979	21,688	27,628	30,703
Capital expenditure	(2,895)	(475)	(2,730)	(2,730)
Change in investments	(8,019)	(2,716)	(5,000)	0
Others	(205)	0	0	(0)
Cash flow from inv. (b)	(11,120)	(3,191)	(7,730)	(2,730)
Free cash flow (a+b)	5,859	18,497	19,898	27,973
Debt raised/(repaid)	(535)	(600)	0	0
Dividend (incl. tax)	(4,439)	(4,673)	(25,460)	(7,009)
Cash flow from fin. (c)	(4,974)	(5,273)	(25,460)	(7,009)
Net chg in cash (a+b+c)	885	13,225	(5,562)	20,963

Key Ratios

Yr end 31 Mar (%)	FY09	FY10E	FY11E	FY12E
Adjusted EPS (Rs)	64.2	111.8	121.3	137.5
Growth	32.6	74.1	8.5	13.3
Book NAV/share (Rs)	190.3	174.6	260.8	363.1
Dividend/share (Rs)	20.0	110.0	30.0	30.0
Dividend payout ratio	36.5	114.1	28.9	25.5
Tax	28.1	21.2	19.5	19.5
EBITDA margin	14.0	17.5	16.5	16.6
EBIT margin	14.5	17.9	16.7	16.8
RoCE	49.0	73.6	66.3	53.0
Net debt/Equity	(90.0)	(147.1)	(97.4)	(98.8)

Valuations

Yr end 31 Mar (x)	FY09	FY10E	FY11E	FY12E
PER	30.1	17.3	15.9	14.0
PCE	26.4	15.9	14.6	12.9
Price/Book	10.1	11.1	7.4	5.3
Yield (%)	1.0	5.7	1.6	1.6
EV/Net sales	2.7	2.1	1.9	1.6
EV/EBITDA	19.3	12.1	11.3	9.9

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY09	FY10E	FY11E	FY12E
Net margin (%)	10.4	14.1	13.4	13.5
Asset turnover	2.2	2.2	2.2	2.2
Leverage factor	1.6	1.9	1.9	1.5
Return on equity (%)	37.8	61.3	55.7	44.1

Bhaumik Bhatia
bhaumik.bhatia@bksec.com
+91-22-4031 7106

Analyst Declaration: I, Bhaumik Bhatia, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

B&K Securities is the trading name of Batlivala & Karani Securities India Pvt. Ltd.

B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, print, publishing, photocopying, recording or otherwise without the permission of Batlivala & Karani Securities India Pvt. Ltd. Any unauthorized act in relation to all or any part of the material in this publication may call for appropriate statutory proceedings.

The information contained herein is confidential and is intended solely for the addressee(s). Any unauthorized access, use, reproduction, disclosure or dissemination is prohibited. This information does not constitute or form part of and should not be construed as, any offer for sale or subscription of or any invitation to offer to buy or subscribe for any securities. The information and opinions on which this communication is based have been complied or arrived at from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to their accuracy, correctness and are subject to change without notice. Batlivala & Karani Securities India P Ltd and/ or its clients may have positions in or options on the securities mentioned in this report or any related investments, may effect transactions or may buy, sell or offer to buy or sell such securities or any related investments. Recipient/s should consider this report only for secondary market investments and as only a single factor in making their investment decision. The information enclosed in the report has not been vetted by the compliance department due to the time sensitivity of the information/document. Some investments discussed in this report have a high level of volatility. High volatility investments may experience sudden and large falls in their value causing losses when the investment is realized. Those losses may equal your original investment. Some investments may not be readily realizable and it may be difficult to sell or realize those investments, similarly it may prove difficult for you to obtain reliable information about the value, risks to which such an investment is exposed. Neither B&K Securities nor any of its affiliates shall assume any legal liability or responsibility for any incorrect, misleading or altered information contained herein.

B & K SECURITIES INDIA PRIVATE LTD.

Equity Research Division: City Ice Bldg, 298, Ground/1st Floor, Perin Nariman Street, Behind RBI, Fort, Mumbai - 400 001, India. Tel: 91-22-4031 7000, Fax: 91-22-2263 5020/30.
Registered Office: Room No. 3/4, 7 Lyons Range, Kolkata - 700 001. Tel.: 91-33-2243 7902.

B&K Research is also available on Bloomberg <BNKI>, Thomson First Call & Investext.