

**STOCK DATA**

Market Cap	Rs165 bn.
Book Value per share	Rs150
Eq Shares O/S (F.V. Rs. 2)	199.7 mn.
Median Volumes (12 mths)	273,570 (BSE+NSE)
52 Week High/Low	Rs895 / 561
Bloomberg Code	HH@IN
Reuters Code	HROH@BO

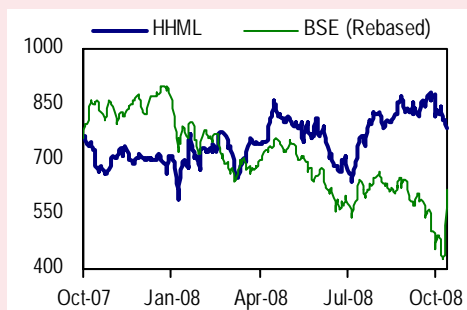
**SHAREHOLDING PATTERN (%)**

Qtr. Ended	Mar-08	Jun-08	Sep-08
Promoters	55.0	55.0	55.0
MFs/UTI/FIs	11.5	11.9	13.3
FIIIs/NRIs/OCBs	24.7	24.3	23.0
PCB	0.7	0.8	0.9
Indian Public	8.1	8.0	7.9

**STOCK PERFORMANCE (%)**

	1M	3M	12M
Absolute	(2.0)	14.1	6.2
Relative	25.2	41.7	48.2

**STOCK PRICE PERFORMANCE**



**KEY HIGHLIGHTS**

**Hero Honda Motors Ltd (HHML) reported a 36% rise in net sales to Rs32bn on back of a 30% YoY growth in volumes to 983k units and 5% improvement in realizations. This was aided by price hikes of 2-3% and richer product-mix. HHML reported a net profit of Rs3bn, an increase of 50% YoY.**

● **Continued outperformance**

HHML continued its outperformance in Q2FY09, gaining market share to the tune of 520bps to 57.8% of domestic market due to robust volumes of *Splendor & Passion* alongwith incremental volumes of *Hunk*.

● **OPM marginally above expectations at 13.6%**

Fall in input costs coupled with price hikes & better product-mix resulted in raw material cost being constant YoY at 72.4%. While staff cost was lower by 30bps, other expenditure declined 100bps on account of higher volumes. Consequently, OPM expanded 120bps to 13.6%

● **4 variants launched**

HHML has launched variants of *Splendor & Passion* (with self-start), a refreshed *CBZ-Xtreme* & a variant of its scooter *Pleasure* in Oct'08. We believe this would help the company fend off competition in the executive & premium segment to some extent.

**VALUATIONS AND RECOMMENDATION**

At CMP of Rs825, HHML is trading at a P/E of 11.2x & EV/EBIDTA of 5.7x its FY10E numbers. On back of better than expected volumes in H1FY09, launch of 4 variants in Oct'08 and possible traction in volumes due to the recommendations of the 6th Pay Commission, we have revised our volume estimates upwards to 10-11% CAGR (8-9% earlier). Also, correction in raw material prices from the peak, price hikes & better product-mix will help augment margins.

The company continues to be cash-rich with no debt, giving it the advantage of funding capex through internal accruals. On back of continued volume outperformance, improved volume outlook, margin expansion & strong cash accruals, we upgrade our recommendation to 'BUY' with a price target of Rs923.

**KEY FINANCIALS (STANDALONE)**

Rs mn	Quarter Ended			Yr Ended (March)				
	Mar-08	Jun-08	Sep-08	2006	2007	2008	2009E	2010E
Net Sales	27,887	28,435	32,021	87,140	99,000	103,318	121,178	136,677
YoY Gr.(%)	5.6	16.2	36.1	17.4	13.6	4.4	17.3	12.8
Op. Profits	4,118	3,410	4,349	13,644	11,730	13,494	15,740	18,315
Op. Marg.(%)	14.8	12.0	13.6	15.7	11.8	13.1	13.0	13.4
Net Profits	2,987	2,729	3,063	9,713	8,579	9,679	12,150	14,749
Eq. Capital	399	399	399	399	399	399	399	399

**KEY RATIOS**

	Yr Ended (March)				
	2006	2007	2008	2009E	2010E
Dil. EPS (Rs)	48.6	43.0	48.5	60.8	73.9
ROCE (%)	69.9	50.5	50.7	47.2	41.8
RONW (%)	55.5	38.3	35.5	36.1	34.6
P/E (x)	17.0	19.2	17.0	13.6	11.2
EV/Sales (x)	1.4	1.3	1.2	0.9	0.8
EV/EBIDT (x)	9.5	10.7	9.1	7.2	5.7

## PERFORMANCE OVERVIEW

The performance of the company was in line with expectations on volumes & margins fronts and above expectations on profitability front.

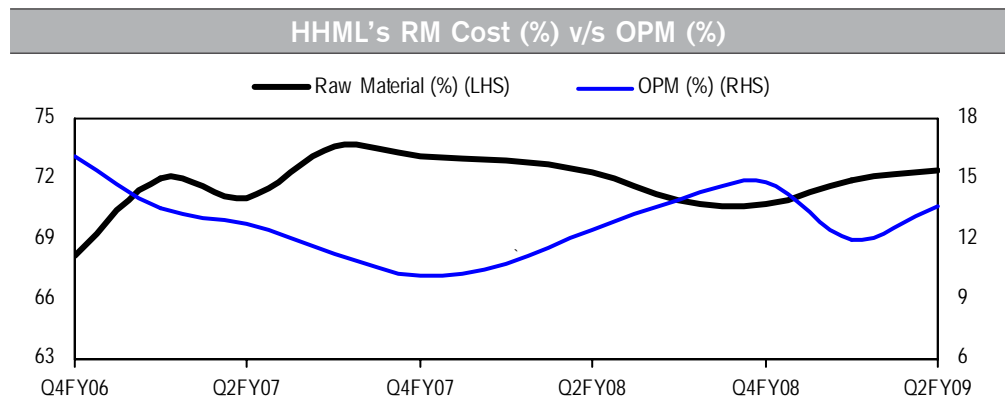
While industry's domestic motorcycle volumes rose by 17% to 1.57 mn units, HHML outperformed with a 29% rise in volumes to 911k units which helped improve market share by 520bps YoY to 57.8%. HHML's market share in the economy segment fell by 370bps YoY to ~29% due to sluggish volumes of CD Dawn. In the executive segment, HHML improved its market share by 500bps to ~72% due to strong volumes of Splendor, Passion & Glamour. In the premium segment, the company gained market share to the tune of 690bps YoY due to incremental volumes of *Hunk* even as CBZ-Xtreme volumes continue to be sluggish. HHML's domestic scooter volumes were higher by 20% YoY, which resulted in 100bps YoY & 250bps QoQ improvement in market share to 12%.

The product-mix of the company improved in favour of executive & premium segment which along with price hikes to the tune of 2-3% helped realisations go up by 5% YoY to Rs32.6k/unit. Net sales rose by 36% to Rs32bn.

OPM expanded by 120bps YoY to 13.6%...

OPM expanded by 120bps YoY to 13.6% due to fall in staff cost and other expenditure by 30bps & 100bps respectively on account of economies of scale from higher volumes. RM cost was stagnant YoY due to fall in input prices, price hikes and better product-mix.

Other income was higher by 37% at Rs539mn on back of treasury gains. Depreciation scaled up 21% to Rs466mn on account of commissioning of Uttaranchal facility. Also, the effective tax rate of the company declined 40bps to 32% on account of savings from Uttaranchal facility commissioned in Apr'08 (it was higher than our estimate of 27%). Consequently, net profits surged by 50% YoY to Rs3bn.



Source: Pinc Research

## Capex plans

In light of a slowdown in domestic 2-wheeler industry, HHML had been delaying commissioning of its Uttaranchal facility for almost 7 months. The company finally commenced operations at this plant in Apr'08 with an initial capacity of 0.5 mn units. The initial investment in the greenfield facility has been ~Rs4.2bn. The company plans to ramp up capacity at this plant to 1.5 mn units over the next 2 years. HHML has shifted production of its high volume motorcycles *Splendor* & *Passion* to this location. This has taken the current capacity of the company to 4.4 mn units which will stand at 5.4 mn units after expansion at Uttaranchal. The plant will provide excise duty & sales tax exemption for 10 years. Also, 100% of income tax for the first 5 years & 30% for the next 5 years will be exempt.

HHML's Uttaranchal facility commenced operations in Apr'08...

## INVESTMENT INCENTIVES

Higher delinquencies have led to tightening of financing, especially in the interest rate sensitive economy segment. However, shortening replacement cycles, higher frequency of new platform introductions and a lower base will assist an improvement in overall volumes. However, in the near term, we expect sluggish growth (5-7%) to continue until interest rates soften following the recent rate cuts. We expect the domestic motorcycle industry to grow at a 8-10% CAGR in volume terms and a growth of 10-11% CAGR in HHML's motorcycle volumes over FY08-10.

*We believe HHML would have to introduce a new platform in the executive segment to retain market share...*

While *Splendor & Passion* platforms continue to be HHML's mainstay in the executive segment, *Glamour FI* has helped offer a choice to customers. Even as the company continues to sweat the fully depreciated assets of its *Splendor & Passion* platforms and has launched variants (self-start variants) of the same in Oct'08, we believe the company would have to introduce a new platform in the segment to fend off competition.

In the premium segment, the company's offerings comprise of *CBZ Xtreme*, *Achiever*, *Karizma* & the recently introduced *Hunk*. While this segment continues to be the mainstay of BAL, HHML is trying to penetrate this segment with its slew of offerings and has garnered a share of almost 20% in H1FY09. Although much smaller in volume terms, the premium segment is the most profitable and could prove to be even more crucial for the OPM of the company in a scenario of further escalation in input costs.

#### **INVESTMENT RISKS**

Rise in interest rates to the tune of 400-500 bps over the past 2-3 quarters and tightening of financing norms by banks contributed to the fall in domestic motorcycle sales in FY08. With increase in the number of delinquencies, banks have further tightened their lending norms. This could prove to be a dampener on the overall industry volumes, until interest rates begin to soften.

We believe there could be a potential loss of market share in the executive segment due to intensifying competition from BAL's *XCD* coupled with the 125cc variant of *Platina* (launched in Sep'08) & TVSM's *Flame* competing with an ageing product portfolio of HHML with no new launches in the segment. This coupled with slowdown in the domestic industry could lead to margin pressure in the near term due to priority of market share over margins.

Furthermore, we believe BAL's strategy of offering higher displacement motorcycles coupled with strong competition from TVSM's *Apache* & Honda's *Unicorn* could result in constant market share in the premium segment.

#### **OUTLOOK**

We expect growth of 10-11% CAGR in HHML's overall volumes over FY08-10. We also expect realisations to improve by 2-3% on back of a richer product-mix resulting in net sales rising to Rs136.7bn in FY10. We have revised our OPM estimated upwards by 30bps for FY10 to 13.4% on account of the recent fall in prices of aluminum & steel coupled with price hikes and improving product-mix. We expect other income to rise by 13-15% to Rs2.5bn & interest income to increase to Rs525mn in FY10. We have lowered our tax estimates by 300bps on back of higher than expected savings at Uttaranchal facility. Thus, we expect earnings to edge up by 22% CAGR to Rs14.2bn translating into an EPS of Rs71.6 for FY10.

#### **VALUATIONS AND RECOMMENDATION**

*At the CMP of Rs825, HHML is trading at a P/E of 11.2x & EV/EBIDTA of 5.7x its FY10E numbers. On back of better than expected volumes in H1FY09, launch of 4 variants in Oct'08 and possible traction in volumes due to the recommendations of the 6th Pay Commission, we have revised our volume estimates upwards to 11% CAGR (9.5% earlier). Also, correction in raw material prices from the peak coupled with price hikes & improving product-mix will help grow margins.*

*Further, the company continues to be cash-rich with no debt giving it the advantage of funding capex through internal accruals. On back of continued outperformance, improved volume outlook, margin expansion & strong cash accruals, we upgrade our recommendation to 'BUY' with a price target of Rs923.*

*We expect growth of 10-11% CAGR in HHML's overall volumes over FY08-10...*

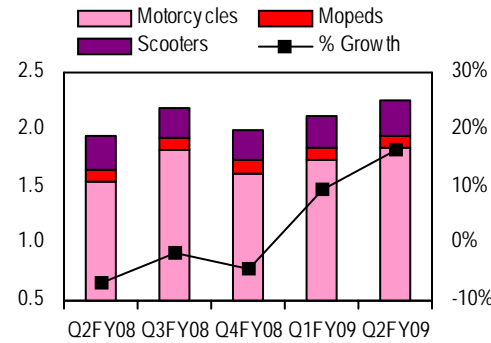
*We upgrade our recommendation to 'BUY' with a price target of Rs923...*

#### **Company description**

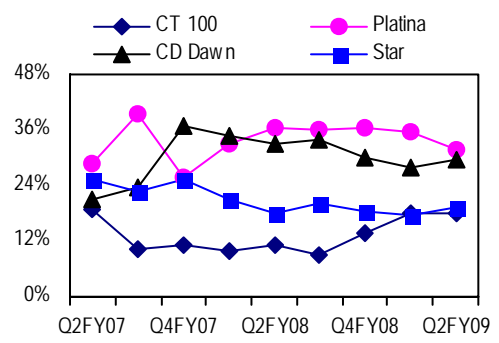
Hero Honda is the largest manufacturer of motorcycles in India. It is a JV between Hero Group (India) & Honda Motors (Japan). It has 2 plants located at Dharuhera & Gurgaon having a capacity of 3.9mn units with the 3rd plant expected to be commissioned in Uttaranchal in FY09. Hero Honda revolutionised motorcycles and brought about the transition from scooters to motorcycles in India more than a decade ago and has maintained its leadership position ever since.

Appendix

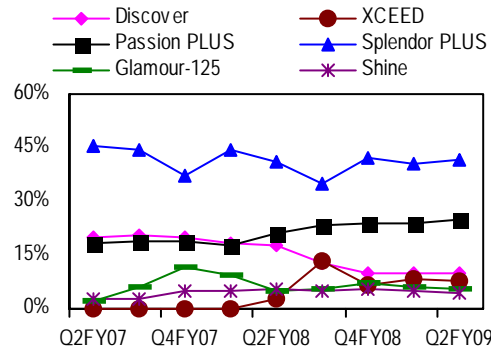
Overall 2-W Industry Volumes (mn)



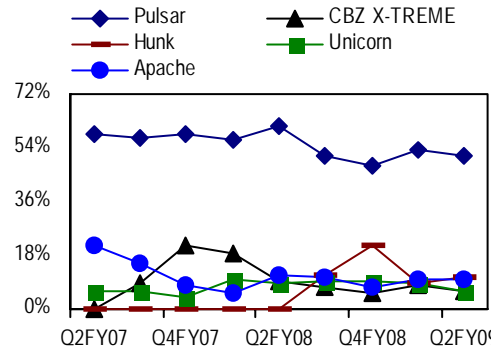
Motorcycle market share (Entry)



Motorcycle market share (Executive)

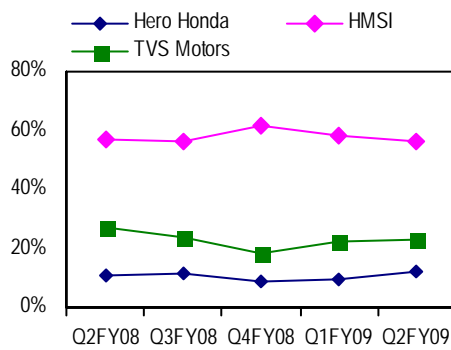


Motorcycle market share (Premium)

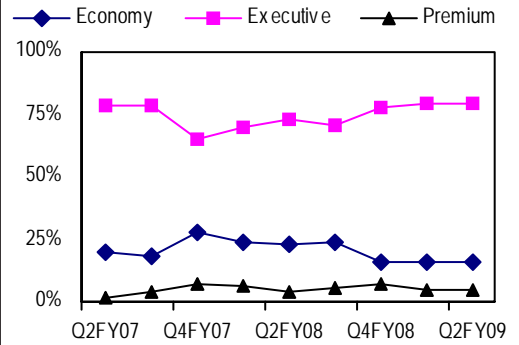


Source: Industry, CRIS Infac

Scooters Market Share



HHML's Product-Mix

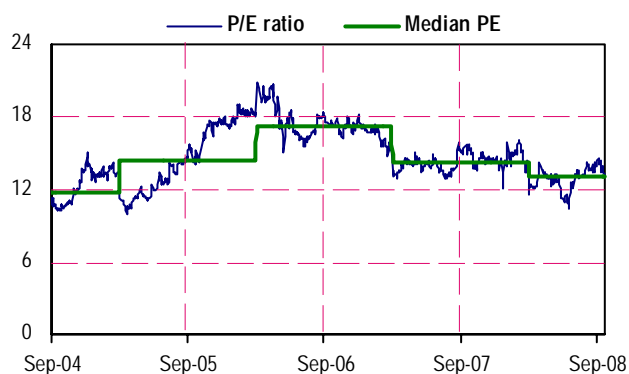


Source: Pinc Research

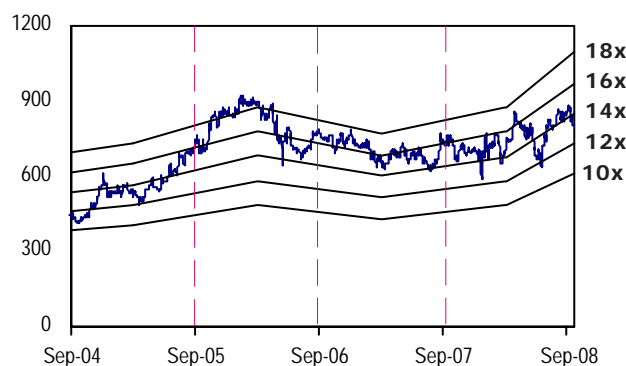
## Financial Results for the quarter & half year ended 30 September 2008 (Standalone)

Particulars (Rs mn)	Quarter Ended			Half Year Ended			Year Ended
	30/09/08	30/09/07	Gr %	30/09/08	30/09/07	Gr %	31/03/08
<b>Net Sales</b>	<b>32,021</b>	<b>23,521</b>	<b>36.1</b>	<b>60,456</b>	<b>48,001</b>	<b>25.9</b>	<b>103,318</b>
<b>Expenditure</b>	27,672	20,606	<b>34.3</b>	52,697	42,452	<b>24.1</b>	89,824
(Inc.) / Dec. in stock	(832)	(973)		(995)	(1,098)		(107.0)
Materials	24,015	17,986	33.5	44,631	35,958	24.1	74,132.4
Staff Cost	1,103	870	26.7	2,142	1,837	16.6	3,834.5
Other expenditure	3,386	2,724	24.3	6,918	5,755	20.2	11,964.4
<b>Operating profit</b>	<b>4,349</b>	<b>2,915</b>	<b>49.2</b>	<b>7,759</b>	<b>5,549</b>	<b>39.8</b>	<b>13,494</b>
Other Income	539	393	<b>37.2</b>	1,006	782	<b>28.7</b>	1,854
<b>PBIDT</b>	<b>4,888</b>	<b>3,307</b>	<b>47.8</b>	<b>8,765</b>	<b>6,331</b>	<b>38.4</b>	<b>15,348</b>
Interest	(83)	(101)	<b>(17.3)</b>	(133)	(190)	(30.1)	(358)
Depreciation	466	384	<b>21.3</b>	888	760	<b>16.8</b>	1,603
<b>PBT</b>	<b>4,505</b>	<b>3,024</b>	<b>49.0</b>	<b>8,010</b>	<b>5,761</b>	<b>39.0</b>	<b>14,103</b>
Provision for tax	1,353	956		2,098	1,804		4,368
Provision for deferred tax	72	18		92	1		12
Provision for FBT	17	7		28	15		44
<b>Net Profit</b>	<b>3,063</b>	<b>2,043</b>	<b>49.9</b>	<b>5,792</b>	<b>3,942</b>	<b>46.9</b>	<b>9,679</b>
Equity Capital (FV Rs 2)	399	399		399	399		399
Reserves (excl. rev. res.)	-	-		-	-		29,463
<b>EPS for the period (Rs)</b>	<b>15.3</b>	<b>10.2</b>		<b>29.0</b>	<b>19.7</b>		<b>48.5</b>
Book Value (Rs)	-	-		-	-		150
<b>OPM (%)</b>	<b>13.6</b>	<b>12.4</b>	<b>1.2</b>	<b>12.8</b>	<b>11.6</b>	<b>1.3</b>	<b>13.1</b>
NPM (%)	9.6	8.7		9.6	8.2		9.4
<b>Expenditure (% of net sales)</b>							
Raw Material	72.4	72.3		72.2	72.6		71.6
Staff Costs	3.4	3.7		3.5	3.8		3.7
Other Exp	10.6	11.6		11.4	12.0		11.6
<b>Volumes (Nos.)</b>	<b>983,143</b>	<b>756,633</b>	<b>29.9</b>	<b>1,861,934</b>	<b>1,559,486</b>	<b>19.4</b>	<b>3,337,142</b>

### Median PE v/s Daily PE



### PE Band



<b>Income Statement</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>
<b>Revenues</b>	74,217	87,140	99,000	103,318	121,178	136,677
<i>Growth (%)</i>	27.2	17.4	13.6	4.4	17.3	12.8
<b>Total Expenditure</b>	62,571	73,496	87,269	89,824	105,438	118,362
<b>Operating Profit</b>	11,645	13,644	11,730	13,494	15,740	18,315
Other Income	1,410	1,563	1,899	1,854	2,285	2,640
<b>EBDIT</b>	13,055	15,207	13,629	15,348	18,025	20,955
(-) Depreciation	894	1,146	1,398	1,603	2,130	2,424
(-) Interest	(11)	(61)	(230)	(358)	(425)	(525)
<b>PBT &amp; Minority Interest</b>	<b>12,173</b>	<b>14,122</b>	<b>12,461</b>	<b>14,103</b>	<b>16,320</b>	<b>19,056</b>
(-) Tax Provision	4,068	4,409	3,882	4,424	4,170	4,307
<b>Net Profits</b>	<b>8,105</b>	<b>9,713</b>	<b>8,579</b>	<b>9,679</b>	<b>12,150</b>	<b>14,749</b>
Fully Diluted Eq. Sh. O/S (mn nos.)	200	200	200	200	200	200
Book Value (Rs)	75	101	124	150	188	239
<b>Basic E.P.S. (Rs)</b>	<b>40.6</b>	<b>48.6</b>	<b>43.0</b>	<b>48.5</b>	<b>60.8</b>	<b>73.9</b>
<b>Fully Diluted E.P.S. (Rs)</b>	<b>40.6</b>	<b>48.6</b>	<b>43.0</b>	<b>48.5</b>	<b>60.8</b>	<b>73.9</b>

<b>Balance Sheet</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009E</b>	<b>2010E</b>
<i>Equity Share Capital</i>	399	399	399	399	399	399
<i>Reserves &amp; Surplus</i>	14,534	19,694	24,301	29,463	37,096	47,327
<b>Net Worth</b>	<b>14,934</b>	<b>20,094</b>	<b>24,701</b>	<b>29,862</b>	<b>37,495</b>	<b>47,727</b>
Total Borrowings	2,018	1,858	1,652	1,320	1,520	1,720
Deferred Tax Liability (Net)	1,009	1,188	1,282	1,254	1,284	1,329
<b>Capital Employed</b>	<b>17,960</b>	<b>23,140</b>	<b>27,634</b>	<b>32,436</b>	<b>40,299</b>	<b>50,775</b>
Fixed Assets	6,745	9,494	11,655	11,563	14,033	13,960
Capital WIP	409	442	1,899	3,924	1,500	1,000
Net Current Assets	(9,459)	(7,415)	(5,659)	(8,880)	(8,731)	(8,406)
Investments	20,267	20,619	19,739	25,668	33,496	44,222
<b>Total Assets</b>	<b>17,960</b>	<b>23,140</b>	<b>27,634</b>	<b>32,436</b>	<b>40,299</b>	<b>50,775</b>

Cash Flow Statement	2005	2006	2007	2008	2009E	2010E
<b>PBT &amp; Extraord. items</b>	<b>12,173</b>	<b>14,122</b>	<b>12,461</b>	<b>14,103</b>	<b>16,320</b>	<b>19,056</b>
Depreciation	894	1,146	1,398	1,603	2,130	2,424
Interest & Div. Income	(1,410)	(1,306)	(1,247)	(1,294)	(2,285)	(2,640)
Interest Paid	(11)	-	(336)	(486)	(425)	(525)
Tax Paid	(3,952)	(4,240)	(3,954)	(4,420)	(4,140)	(4,262)
Misc Exp & Extra ordinary items	-	-	-	-	161	-
(Inc.)/Dec. in WC	1,789	(362)	(2,072)	2,612	1,040	175
<b>Cash from Operations</b>	<b>9,482</b>	<b>9,361</b>	<b>6,250</b>	<b>12,118</b>	<b>12,801</b>	<b>14,228</b>
Net Capital exp.	(2,104)	(3,937)	(5,152)	(3,739)	(2,177)	(1,850)
Net Investment	(4,616)	700	2,162	(4,626)	(7,828)	(10,726)
Interest & Div Recd.	1,410	2	218	555	2,285	2,640
<b>Cash from Investing Act.</b>	<b>(5,310)</b>	<b>(3,235)</b>	<b>(2,772)</b>	<b>(7,810)</b>	<b>(7,719)</b>	<b>(9,935)</b>
Issue of Equity shares	-	-	-	-	-	-
Change in Loans (incl. FCCBs)	271	(160)	(206)	(332)	200	200
Interest	11	(29)	(16)	(20)	425	525
Equity Div. paid (incl. tax)	(4,517)	(4,523)	(4,712)	(3,972)	(4,517)	(4,517)
<b>Cash from Financing Act.</b>	<b>(4,236)</b>	<b>(4,712)</b>	<b>(4,935)</b>	<b>(4,323)</b>	<b>(3,892)</b>	<b>(3,792)</b>
<b>Inc/(Dec) in Cash</b>	<b>(64)</b>	<b>1,413</b>	<b>(1,457)</b>	<b>(16)</b>	<b>1,189</b>	<b>500</b>

Key Ratios	2005	2006	2007	2008	2009E	2010E
EBIDT (%)	17.6	17.5	13.8	14.9	14.9	15.3
ROACE (%)	77.5	69.9	50.5	50.7	47.2	41.8
ROANW (%)	61.6	55.5	38.3	35.5	36.1	34.6
Sales/Total Assets (x)	0.2	0.2	0.2	0.3	0.3	0.3
Debt:Equity (x)	0.1	0.1	0.1	0.0	0.0	0.0
Current Ratio (x)	0.4	0.5	0.6	0.5	0.6	0.6
Debtors (Days)	3.8	5.7	10.5	8.9	7.0	7.9
Inventory (Days)	11.8	11.1	11.4	12.7	12.0	12.0
Working Capital (Days)	(39.7)	(26.5)	(17.6)	(26.5)	(22.7)	(19.5)
EV/Sales (x)	1.7	1.4	1.3	1.2	0.9	0.8
EV/EBIDT (x)	11.2	9.5	10.7	9.1	7.2	5.7
P/E (x)	20.4	17.0	19.2	17.0	13.6	11.2
P/BV (x)	11.0	8.2	6.7	5.5	4.4	3.5

## TEAM

### EQUITY DESK

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Sailav Kaji	Head Derivatives & Strategist	<i>sailavk@pinc.co.in</i>	91-22-6618 6344

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### DEALING

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