

Hero Honda

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In a safer zone

We met the management of Hero Honda in Delhi. As with other companies, HH too is not very clear about the demand outlook in the near- to medium-term. Having said this, we observed that the management has been cautious in view of the slowing economic momentum, and trying not to sound very optimistic. We believe that HH will remain in a safer zone vis-à-vis peers in terms of volume and profit outlook. But, we maintain our Underperformer rating with a price target of Rs 765 in view of higher valuations.

Demand to shrink in H2FY09, FY10 could be challenging

Management expects the H2FY09 demand growth to be negative for the two-wheeler industry, though HH may beat the street by a flat YoY volume. HH continues to enjoy higher volumes due to its strong presence in the rural markets, which are primarily driven by cash sales. Rural markets now constitute ~55-60% of HH sales against 40% just two years back. Cash sales are now close to 90% of its annual volumes. The strong H1FY09 demand was strongly supported by a surprise 10-12% growth in the northern market.

However, FY10 could be a challenging year and the management believes it would be difficult to sustain the current market share, estimating FY10 volume growth of 5-6%. HH plans 6 new launches over next 15 months, 2 new models and 4 variants.

Margins to improve sequentially in Dec'08 quarter

The company has witnessed some correction in input costs. It expects the H2FY09 margins to be better than H1, though the maximum impact would be seen only in Q4FY09. The excise duty cut impact on account of inventory (now reduced to 20 days) is likely to be shared between the dealers and the company, though a final decision is pending. The company has not passed on the entire benefit in the high-end segment, which may add to the overall margins in the coming quarters.

Uttaranchal plant to double production in FY10

FY09 production in Uttaranchal during FY09 will be 6 lakh units, targeted to double in FY10 at 1.2 million units. At the same time, the ancillarisation level will improve from 30% in FY09 to 65% in FY10.

Other key takeaways:

- Capex for FY09 and FY10 to be Rs 2.5bn and Rs 1.75bn, respectively.
- No discounts/offers planned as of now.
- Have been supporting dealers through inventory funding via HH Finlease.

Valuation summary

Y/E Mar, Rs mn	FY2006	FY2007	FY2008	FY2009E	FY2010E
Net Sales	87,140	99,000	103,318	119,387	130,544
Growth, %	17.4	13.6	4.4	15.6	9.3
EBIDTA	13,645	11,731	13,494	16,188	18,252
EBIDTA margins, %	15.7	11.8	13.1	13.6	14.0
Net profit	9,713	8,579	9,679	12,486	14,191
Net profit margins, %	11.1	8.7	9.4	10.5	10.9
EPS, Rs	48.6	43.0	48.5	62.5	71.1
EPS Growth, %	19.8	(11.7)	12.8	29.0	13.7
PER, x	16.9	19.1	17.0	13.1	11.6
EV/EBIDTA, x	11.8	13.8	11.9	9.7	8.2
EV/Net Sales, x	1.8	1.6	1.6	1.3	1.1
Price/Book Value, x	8.2	6.6	5.5	4.3	3.5
ROE, %	55.5	38.3	35.5	36.9	33.4
Dividend Yield, %	2.1	2.1	2.3	2.4	2.7

Source: Company, MF Global India Research Estimates

Maintain Underperformer
Rs 822 / Target Rs 765 (-7%)

Sector Rating

OW	N	UW

Stock Rating

B	OP	N	UP	S
> 10%	5% to 10%	5% to -5%	-5% to -10%	< -10%

This note should be read for

- Business outlook

Bloomberg code : HH IN
Reuters code : HROH.BO
www.herohonda.com

BSE Sensex : 10076
NSE Nifty : 3061

Company data

O/S shares :	200mn
Market cap (Rs) :	164bn
Market cap (USD) :	3.5bn
52 - wk Hi/Lo (Rs) :	898 / 550
Avg. daily vol. (3mth) :	0.7mn
Face Value (Rs) :	2

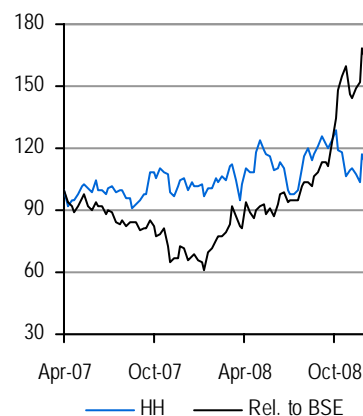
Share holding pattern, %

Promoters :	55.0
FII / NRI :	22.9
FI / MF :	13.3
Non Promoter Corp. Holdings :	0.9
Public & Others :	8.0

Price performance, %

	1mth	3mth	1yr
Abs	13.7	-2.0	16.4
Rel to BSE	1.0	22.3	63.6

Price vs. Sensex



Source: Bloomberg, MF Global India Research

FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY2006	FY2007	FY2008	FY2009E	FY2010E
Net sales	87,140	99,000	103,318	119,387	130,544
<i>Growth, %</i>	<i>17.4</i>	<i>13.6</i>	<i>4.4</i>	<i>15.6</i>	<i>9.3</i>
cTotal income	87,140	99,000	103,318	119,387	130,544
Operating expenses	73,495	87,269	89,824	103,199	112,292
EBITDA	13,645	11,731	13,494	16,188	18,252
<i>Growth, %</i>	<i>17.2</i>	<i>(14.0)</i>	<i>15.0</i>	<i>20.0</i>	<i>12.7</i>
<i>Margin, %</i>	<i>15.7</i>	<i>11.8</i>	<i>13.1</i>	<i>13.6</i>	<i>14.0</i>
Depreciation	1,146	1,398	1,603	1,898	2,314
EBIT	12,498	10,333	11,891	14,290	15,938
<i>Growth, %</i>	<i>16.2</i>	<i>(17.3)</i>	<i>15.1</i>	<i>20.2</i>	<i>11.5</i>
<i>Margin, %</i>	<i>14.3</i>	<i>10.4</i>	<i>11.5</i>	<i>12.0</i>	<i>12.2</i>
Interest received	196.1	352.4	506.2	456.3	521.9
Interest paid	29	16	20	40	45
Net interest Expense	-166.9	-336.3	-486.2	-416.3	-476.9
Forex gains/(losses)	0	0	14	0	0
Non-operating items	1,457	1,792	1,712	1,942	2,136
Pre-tax profit	14,122	12,462	14,103	16,648	18,551
Tax provided	4,409	3,882	4,424	4,162	4,359
MF Profit after tax	9,713	8,579	9,679	12,486	14,191
<i>Growth, %</i>	<i>19.8</i>	<i>(11.7)</i>	<i>12.8</i>	<i>29.0</i>	<i>13.7</i>
Reported PAT	9,713	8,579	9,679	12,486	14,191
Extraordinary items: Gains/(Losses)	0	0	0	0	0
Unadj. shares (m)	200	200	200	200	200
Wtd avg shares (m)	200	200	200	200	200

Cash Flow

Y/E Mar, Rs mn	FY2006	FY2007	FY2008	FY2009E	FY2010E
PBT	14,122	12,462	14,103	16,648	18,551
Depreciation, amortisation	1,146	1,398	1,603	1,898	2,314
Chg in working capital	-792	-3,192	3,842	-1,249	534
Total taxes paid	-4,230	-3,788	-4,452	-4,162	-4,359
Other operating activities	-521	-344	0	0	0
Cash flow from operating activities (a)	9,725	6,535	15,096	13,136	17,039
Capital expenditure	-3,929	-5,017	-3,696	-2,550	-1,700
Chg in investments	-174	673	-5,493	-2,500	-2,000
Chg in marketable securities	-178	207	-437	0	0
Other investing activities	-489	-221	-970	0	0
Cash flow from investing activities (b)	-4,770	-4,358	-10,596	-5,050	-3,700
Free cash flow	4,955	2,178	4,500	8,086	13,339
Equity raised/(repaid)	1,000	900	892	-	-
Debt raised/(repaid)	0	0	0	0	0
Dividend (incl tax)	-3,954	-3,972	-4,439	-4,513	-4,965
Other financial activities	-590	-336	0	0	0
Cash flow from financing activities (c)	-3,544	-3,408	-3,547	-4,513	-4,965
Net chg in cash (a)+(b)+(c)	1,411	-1,230	953	3,572	8,374

Balance Sheet

As at 31st Mar, Rs mn	FY2006	FY2007	FY2008	FY2009E	FY2010E
Cash & bank	1,587	358	1,311	4,884	13,258
Marketable securities at cost	1,855	1,648	2,085	2,085	2,085
Debtors	1,587	3,353	2,974	3,925	4,292
Inventory	2,266	2,756	3,171	3,598	3,934
Loans & advances	2,738	2,631	1,855	3,104	3,916
Other current assets	35	36	57	50	75
Total current assets	6,625	8,775	8,057	10,677	12,217
Investments	18,764	18,091	23,584	26,084	28,084
Gross fixed assets	14,720	18,006	19,388	25,273	27,323
Less: Depreciation	5,226	6,351	7,825	9,723	12,037
Add: Capital WIP	442	1,899	4,085	750	400
Net fixed assets	9,936	13,555	15,648	16,299	15,685
Total Non-current assets	28,700	31,646	39,231	42,383	43,769
Total Assets	38,767	42,426	50,684	60,029	71,329
Current liabilities	10,729	10,419	13,250	14,506	15,803
Provisions	4,899	4,372	4,998	5,113	5,890
Total current liabilities	15,628	14,792	18,247	19,619	21,693
Non-current liabilities	3,046	2,934	2,574	2,574	2,574
Total liabilities	18,674	17,725	20,821	22,193	24,267
Paid-up capital	399	399	399	399	399
Reserves & surplus	19,694	24,301	29,463	37,436	46,663
Shareholders' equity	20,093	24,701	29,862	37,835	47,062
Total Equity & Liabilities	38,767	42,426	50,684	60,028	71,329

Per-share data

	FY2006	FY2007	FY2008	FY2009E	FY2010E
MF EPS (INR)	48.6	43.0	48.5	62.5	71.1
Growth %	19.8	(11.7)	12.8	29.0	13.7
Book NAV/share (INR)	100.6	123.7	149.5	189.5	235.7
FDEPS (INR)	48.6	43.0	48.5	62.5	71.1
CEPS (INR)	54.4	50.0	56.5	72.0	82.7
CFPS (INR)	44.0	25.5	67.0	56.1	74.6
DPS (INR)	17.0	17.0	19.0	20.0	22.0

Financial structure

	FY2006	FY2007	FY2008	FY2009E	FY2010E
Total debt/Equity (x)	0.0	0.0	0.0	0.0	0.0
Net debt/Equity (x)	(0.2)	(0.1)	(0.2)	(0.1)	(0.1)

Profitability, Productivity, Liquidity and Valuation Ratios

	FY2006	FY2007	FY2008	FY2009E	FY2010E
Return on assets (%)	27.1	21.2	20.8	22.6	21.6
Return on equity (%)	55.5	38.3	35.5	36.9	33.4
Return on capital employed (%)	38.3	28.6	27.9	30.1	28.1
Cost of capital (%)	9.8	10.2	10.2	10.2	10.2
RoCE - Cost of capital (%)	28.5	18.4	17.7	20.0	17.9
Sales/Total assets (x)	2.4	2.4	2.2	2.2	2.0
Sales/Net FA (x)	10.2	8.4	7.1	7.5	8.2
Working capital/Sales (x)	0.0	0.0	-0.1	0.0	0.0
Fixed capital/Sales (x)	0.1	0.1	0.0	0.0	0.0
Receivable days	7	12	11	12	12
Inventory days	9	10	11	11	11
Payable days	32	23	31	28	28
Current ratio (x)	0.9	1.0	0.9	1.2	1.7
Quick ratio (x)	0.7	0.8	0.6	1.0	1.5
Interest cover (x)	n/a	n/a	n/a	n/a	n/a
Dividend cover (x)	2.9	2.5	2.6	3.1	3.2
PER (x)	16.9	19.1	17.0	13.1	11.6
PEG (x) - 2 yr CAGR growth			0.8		
PCE (x)	15.1	16.5	14.6	11.4	9.9
PCF (x)	18.7	32.3	12.3	14.7	11.0
Price/Book (x)	8.2	6.6	5.5	4.3	3.5
Yield (%)	2.1	2.1	2.3	2.4	2.7
EV/Net sales (x)	1.8	1.6	1.6	1.3	1.1
EV/EBITDA (x)	11.8	13.8	11.9	9.7	8.2
EV/EBIT (x)	12.9	15.7	13.5	11.0	9.3
EV/NOPLAT (x)	18.7	22.8	19.7	14.7	12.2
EV/CE	5.7	5.1	4.3	3.4	2.7
EV/IC (x)	74.4	22.8	16.6	15.5	13.6

Source: Company, MF Global India Research Estimates

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