

## EARNINGS REVIEW

# Hero Honda Motors (HROH.BO)

Buy

## Above expectations – Earnings upgrade cycle continues, retain Buy

### What surprised us

Hero Honda announced 4QFY10 net income at Rs5.9.bn which was up 49% on yoy basis, 22% above our estimate of Rs4.9bn and 7% above Reuters consensus estimate of Rs5.5bn. For FY2010, the company announced net income of Rs22.3bn which was up 74% on yoy basis and 5% above our estimate. The company also announced dividend of Rs30/share for FY2010 in addition to the special dividend of Rs80/share already announced on March 30. Hero Honda reported a lower tax rate at 18.8% for 4QFY10 vs. 20.5% for 3QFY10 and 28% in 4QFY09, which we believe was driven by improved utilization and local sourcing at its Haridwar plant in Uttaranchal, where the industry enjoys excise and direct tax benefits. The company guided industry volume growth of 13%-15% in FY11E, in line with our estimate.

### What to do with the stock

We continue to like the stock given that: 1) We believe the Indian 2-wheeler industry is undergoing a demand upswing; 2) Hero Honda enjoys a dominant franchise in this market with a track record of 11 consecutive years of top quartile cash returns among global auto peers in our view; and 3) the stock is trading at 14.9X FY11E P/E (excluding the impact of dividend) which is below its upcycle average of 16.0X, and compares with an average of 14.5x for Indian peers and 15.7X for global peers. We maintain our Buy rating and 12-month target price of Rs1,912 based on 16X FY11E P/E (upcycle average). Risks: Higher than expected commodity costs and interest rates, higher than expected success of competitors like Bajaj Auto and Honda Motorcycles.

### Hero Honda FY10 result snapshot

P&L (Rs mn)	Annual Results					Quarter Results				
	FY10A	FY09A	FY10E	Y-o-Y %	Vs Est	4QFY10A	4QFY09A	4QFY10E	Y-o-Y %	Vs Est
Net sales	157,582	123,191	158,547	27.9%	-0.6%	40,926	34,118	41,891	20.0%	-2.3%
EBITDA	27,670	17,475	27,527	58.3%	0.5%	7,117	5,491	6,975	29.6%	2.0%
EBITDA margin	17.6%	14.2%	17.4%	+ 20 bps	+ 20 bps	17.4%	16.1%	16.7%	+ 74 bps	+ 74 bps
Net income	22,318	12,818	21,222	74.1%	5.2%	5,988	4,022	4,892	48.9%	22.4%
Net income margin	14.2%	10.4%	13.4%	+ 78 bps	+ 78 bps	14.6%	11.8%	11.7%	+ 295 bps	+ 295 bps
EPS	111.77	64.19	106.28	74.1%	5.2%	29.99	20.14	24.51	48.9%	22.4%

Source: Company data.

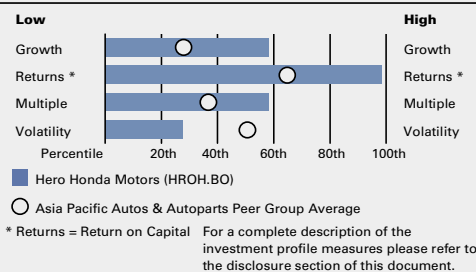
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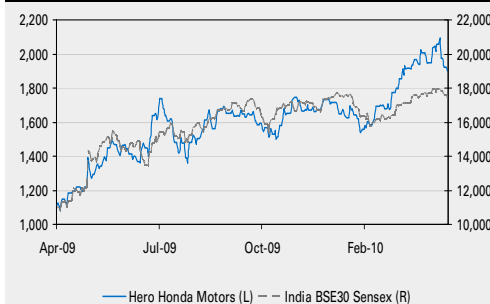
### Investment Profile



Key data	Current
Price (Rs)	1,896.90
12 month price target (Rs)	1,912.00
Market cap (Rs mn / US\$ mn)	378,787.2 / 8,546.6
Foreign ownership (%)	30.6

	3/09	3/10E	3/11E	3/12E
EPS (Rs)	64.19	106.28	119.71	140.02
EPS growth (%)	32.4	65.6	12.6	17.0
EPS (diluted) (Rs)	64.19	106.28	119.71	140.02
EPS (basic pre-ex) (Rs)	64.19	106.28	119.71	140.02
P/E (X)	29.6	17.8	15.8	13.5
P/B (X)	10.0	9.4	8.8	8.1
EV/EBITDA (X)	9.2	13.6	11.9	10.1
Dividend yield (%)	1.1	4.2	4.8	5.6
ROE (%)	37.8	54.1	57.1	62.3

### Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	13.5	14.9	70.8
Rel. to India BSE30 Sensex	14.0	14.4	8.2

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 4/19/2010 close.

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# Hero Honda Motors: Summary financials

Profit model (Rs mn)	3/09	3/10E	3/11E	3/12E	Balance sheet (Rs mn)	3/09	3/10E	3/11E	3/12E
<b>Total revenue</b>	<b>123,191.2</b>	<b>158,547.0</b>	<b>183,606.4</b>	<b>209,750.7</b>	Cash & equivalents	2,195.7	4,282.5	6,476.5	9,393.3
Cost of goods sold	(91,017.5)	(111,874.7)	(129,934.5)	(147,486.2)	Accounts receivable	1,499.4	1,929.7	2,234.7	2,552.9
SG&A	(13,684.2)	(16,534.1)	(19,710.5)	(22,628.9)	Inventory	3,268.3	4,017.3	4,665.8	5,296.0
R&D	0.0	0.0	0.0	0.0	Other current assets	3,171.5	3,171.5	3,171.5	3,171.5
Other operating profit/(expense)	(2,821.3)	(4,300.8)	(4,406.9)	(4,854.4)	<b>Total current assets</b>	<b>10,134.9</b>	<b>13,400.9</b>	<b>16,548.5</b>	<b>20,413.8</b>
<b>EBITDA</b>	<b>17,474.8</b>	<b>27,527.2</b>	<b>31,424.2</b>	<b>36,830.9</b>	Net PP&E	16,942.5	18,252.7	19,383.0	20,333.2
Depreciation & amortization	(1,806.6)	(1,689.8)	(1,869.8)	(2,049.8)	Net intangibles	86.5	86.5	86.5	86.5
<b>EBIT</b>	<b>15,668.2</b>	<b>25,837.4</b>	<b>29,554.4</b>	<b>34,781.2</b>	Total investments	33,687.5	33,687.5	33,687.5	33,687.5
Interest income	316.8	316.8	316.8	316.8	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	--	--	--	--	<b>Total assets</b>	<b>60,851.4</b>	<b>65,427.7</b>	<b>69,705.5</b>	<b>74,521.0</b>
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Accounts payable	7,316.2	9,415.9	10,904.2	12,456.9
Others	1,829.6	1,769.4	1,581.7	1,691.4	Short-term debt	124.5	124.5	124.5	124.5
<b>Pretax profits</b>	<b>17,814.6</b>	<b>27,923.6</b>	<b>31,452.9</b>	<b>36,789.4</b>	Other current liabilities	13,212.0	13,212.0	13,212.0	13,212.0
Income tax	(4,997.0)	(6,701.7)	(7,548.7)	(8,829.4)	<b>Total current liabilities</b>	<b>20,652.7</b>	<b>22,752.4</b>	<b>24,240.7</b>	<b>25,793.4</b>
Minorities	0.0	0.0	0.0	0.0	Long-term debt	660.4	660.4	660.4	660.4
<b>Net income pre-preferred dividends</b>	<b>12,817.6</b>	<b>21,221.9</b>	<b>23,904.2</b>	<b>27,959.9</b>	Other long-term liabilities	1,530.8	1,530.8	1,530.8	1,530.8
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	2,191.2	2,191.2	2,191.2	2,191.2
<b>Net income (pre-exceptionals)</b>	<b>12,817.6</b>	<b>21,221.9</b>	<b>23,904.2</b>	<b>27,959.9</b>	<b>Total liabilities</b>	<b>22,843.9</b>	<b>24,943.6</b>	<b>26,431.9</b>	<b>27,984.6</b>
Post-tax exceptionals	0.0	0.0	0.0	0.0	<b>Preferred shares</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Net income</b>	<b>12,817.6</b>	<b>21,221.9</b>	<b>23,904.2</b>	<b>27,959.9</b>	<b>Total common equity</b>	<b>38,007.5</b>	<b>40,484.0</b>	<b>43,273.6</b>	<b>46,536.4</b>
EPS (basic, pre-exception) (Rs)	64.19	106.28	119.71	140.02	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, post-exception) (Rs)	64.19	106.28	119.71	140.02	<b>Total liabilities &amp; equity</b>	<b>60,851.4</b>	<b>65,427.7</b>	<b>69,705.5</b>	<b>74,521.0</b>
EPS (diluted, post-exception) (Rs)	64.19	106.28	119.71	140.02	<b>BVPS (Rs)</b>	<b>190.33</b>	<b>202.74</b>	<b>216.71</b>	<b>233.05</b>
DPS (Rs)	20.00	80.24	90.38	105.71					
Dividend payout ratio (%)	31.2	75.5	75.5	75.5					
Free cash flow yield (%)	6.9	5.6	6.2	7.4					
<b>Growth &amp; margins (%)</b>	<b>3/09</b>	<b>3/10E</b>	<b>3/11E</b>	<b>3/12E</b>	<b>Ratios</b>	<b>3/09</b>	<b>3/10E</b>	<b>3/11E</b>	<b>3/12E</b>
Sales growth	19.2	28.7	15.8	14.2	ROE (%)	37.8	54.1	57.1	62.3
EBITDA growth	26.4	57.5	14.2	17.2	ROA (%)	23.0	33.6	35.4	38.8
EBIT growth	28.2	64.9	14.4	17.7	ROACE (%)	37.9	57.0	63.5	73.4
Net income growth	32.4	65.6	12.6	17.0	Inventory days	12.9	11.9	12.2	12.3
EPS growth	32.4	65.6	12.6	17.0	Receivables days	6.6	3.9	4.1	4.2
Gross margin	26.1	29.4	29.2	29.7	Payable days	30.4	27.3	28.5	28.9
EBITDA margin	14.2	17.4	17.1	17.6	Net debt/equity (%)	(3.7)	(8.6)	(13.2)	(18.5)
EBIT margin	12.7	16.3	16.1	16.6	Interest cover - EBIT (X)	NM	NM	NM	NM
<b>Cash flow statement (Rs mn)</b>	<b>3/09</b>	<b>3/10E</b>	<b>3/11E</b>	<b>3/12E</b>	<b>Valuation</b>	<b>3/09</b>	<b>3/10E</b>	<b>3/11E</b>	<b>3/12E</b>
Net income pre-preferred dividends	12,817.6	21,221.9	23,904.2	27,959.9	P/E (analyst) (X)	29.6	17.8	15.8	13.5
D&A add-back	1,806.6	1,689.8	1,869.8	2,049.8	P/B (X)	10.0	9.4	8.8	8.1
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	9.2	13.6	11.9	10.1
Net (inc)/dec working capital	2,398.5	920.5	534.7	604.2	Dividend yield (%)	1.1	4.2	4.8	5.6
Other operating cash flow	(2,897.2)	0.0	0.0	0.0					
<b>Cash flow from operations</b>	<b>14,125.5</b>	<b>23,832.2</b>	<b>26,308.7</b>	<b>30,613.9</b>					
Capital expenditures	(3,135.4)	(3,000.0)	(3,000.0)	(3,000.0)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	0.0	0.0	0.0	0.0					
Others	(6,037.0)	0.0	0.0	0.0					
<b>Cash flow from investments</b>	<b>(9,172.4)</b>	<b>(3,000.0)</b>	<b>(3,000.0)</b>	<b>(3,000.0)</b>					
Dividends paid (common & pref)	(4,438.9)	(18,745.4)	(21,114.7)	(24,697.1)					
Inc/(dec) in debt	(535.1)	0.0	0.0	0.0					
Common stock issuance (repurchase)	0.0	0.0	0.0	0.0					
Other financing cash flows	905.7	0.0	0.0	0.0					
<b>Cash flow from financing</b>	<b>(4,068.3)</b>	<b>(18,745.4)</b>	<b>(21,114.7)</b>	<b>(24,697.1)</b>					
<b>Total cash flow</b>	<b>884.8</b>	<b>2,086.8</b>	<b>2,194.0</b>	<b>2,916.8</b>					

Note: Last actual year may include reported and estimated data.  
Source: Company data, Goldman Sachs Research estimates.

## Analyst Contributors

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## Reg AC

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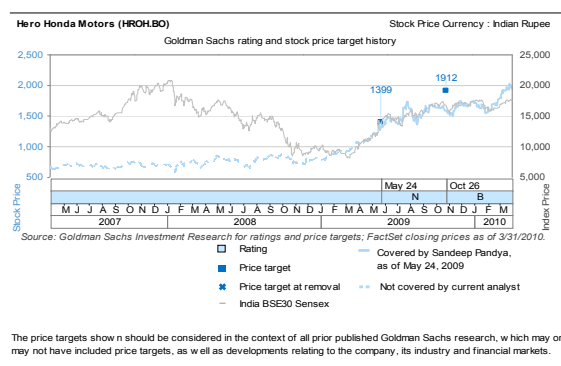
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## Price target and rating history chart(s)



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