

Morgan Stanley India Company
Private Limited+

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Stock Rating
Underweight

Industry View
In-Line

Hero Honda Motor Ltd

F4Q10 Results: In Line at Operating Level; Valuation Stretched

F4Q10 Results: HH reported a good set of numbers, with revenue, EBITDA, and PAT growth of 20%, 30% and 49%, respectively, on a YoY basis. The numbers were in line with our estimates at the sales level but were 2% ahead of our estimates at the EBITDA level. Given slowing earnings growth, the current valuation at 16x appears stretched to us and we would prefer Bajaj Auto (Equal-weight) over Hero Honda in the two-wheeler space.

Margins Flat Sequentially: The company was able to maintain margins against our assumption of a margin decline as increased localization at Uttaranchal led to lower raw material costs; overall raw material cost as a percentage of sales came down to 67.2%, down 120bp QoQ. The company will renegotiate raw material prices in April, and so could see raw material pressures in F1Q11. Other expenses went up due to a Rs300mn advertising charge relating to IPL (Indian Premier League, a cricket event) and the Hockey World Cup. A similar charge will be included in F1Q11 earnings.

Uttaranchal Lower Tax Rate to 18.5%; Company Guidance Is in Line with Estimates: The company produced around 368k units at Uttaranchal in F4Q10 and 1.4mn in F2010. Given the increased contribution from excise-exempt Uttaranchal, the overall tax rate was down to 18.7%. The company expects 10% volume growth and 1.8mn units out of Uttaranchal. Guidance is for margins to remain in the 16-17% range and the F2011 tax rate to be around 20%. The company's volume and margin outlook is in line with our estimates.

Other Income: Other income rose 57% YoY and was 26% ahead of our estimates. Taking into account the special dividend payout (Rs110) in F2010, incrementally other income growth should slow down.

Key Ratios and Statistics

Reuters: HROH.BO Bloomberg: HH IN

India Two-Wheelers

Price target	Rs1,652.00
Upside to price target (%)	(14)
Shr price, close (Apr 16, 2010)	Rs1,919.50
52-Week Range	Rs2,094.00-1,061.00
Sh out, dil, curr (mn)	200
Mkt cap, curr (mn)	Rs383,300
EV, curr (mn)	Rs348,202
Avg daily trading value (mn)	Rs118

Fiscal Year ending	03/09	03/10e	03/11e	03/12e
ModelWare EPS (Rs)	64.19	109.17	118.49	125.74
Consensus EPS (Rs)§	64.09	107.00	118.02	130.59
Revenue, net (Rs mn)	123,569	158,784	175,115	196,312
EBITDA (Rs mn)	17,475	27,427	28,742	30,816
ModelWare net inc (Rs mn)	12,818	21,799	23,660	25,108
P/E	16.7	17.8	16.2	15.3
P/BV	5.6	7.4	5.5	4.4
RNOA (%)	132.9	261.5	288.8	316.4
ROE (%)	42.9	57.4	44.9	36.2
EV/EBITDA	10.2	12.2	10.9	9.6
Div yld (%)	1.9	2.1	2.6	2.6
FCF yld ratio (%)	5.7	5.7	5.6	5.9
Leverage (EOP) (%)	(92.3)	(99.4)	(100.0)	(100.4)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

e = Morgan Stanley Research estimates

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Exhibit 1

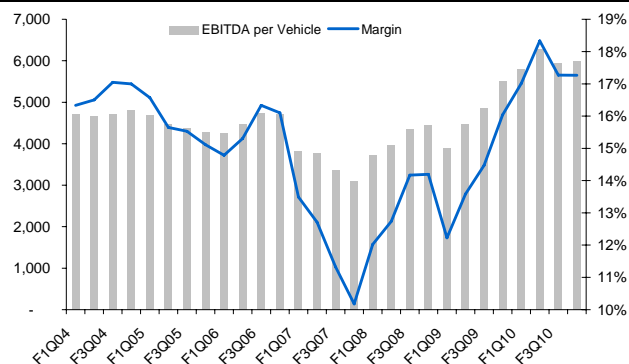
F4Q10 Score Card – Beats Estimates by 6%

Hero Honda (Rs Mn)	F4Q09	F3Q10	F4Q10	F4Q10e	A v/s E	YoY	QoQ
Volume	997,855	1,111,372	1,186,536	1,186,536	0.0%	18.9%	6.8%
Average Realization (LHS)	34,192	34,322	34,492	34,493	0.0%	0.9%	0.5%
Net Sales	34,225	38,270	41,223	41,078	0.4%	20.4%	7.7%
Total Expenditure	28,734	31,661	34,106	34,127	-0.1%	18.7%	7.7%
EBITDA	5,491	6,609	7,117	6,951	2.4%	29.6%	7.7%
Depreciation	444	469	481	481	0.0%	8.4%	2.5%
EBIT	5,047	6,140	6,637	6,470	2.6%	31.5%	8.1%
Other Income	442	550	695	550	26.3%	57.1%	26.5%
Net Interest	(96.30)	(45.90)	(44.70)	(45.90)	-2.6%	-53.6%	-2.6%
PBT	5,586	6,736	7,376	7,066	4.4%	32.1%	9.5%
Tax	1,564	1,378	1,382	1,413	-2.2%	-11.6%	0.3%
PAT	4,022	5,358	5,994	5,653	6.0%	49.0%	11.9%
EBIDTA Margin (%)	16	17	17	17	34 bps	122 bps	0 bps
PBT Margin (%)	16	18	18	17	69 bps	157 bps	29 bps
Net Margin (%)	12	14	15	14	78 bps	279 bps	54 bps
Tax Rate (%)	28	20	18.7	20	-126 bps	-926 bps	-172 bps
Operating leverage (%)	25	0	0	0	0 bps	-2498 bps	0 bps
EPS	20	27	30	28	6.0%	49.0%	11.9%
Materials (%)	6.3	5.8	6.4	5.8	65 bps	14 bps	65 bps
Staff Cost (%)	68.9	68.3	67.2	68.5	-138 bps	-170 bps	-116 bps
Other Expenditure (%)	3.5	3.6	3.5	3.3	20 bps	7 bps	-4 bps
Net raw Materials	23,479	26,051	27,794	-	#DIV/0!	18.4%	6.7%
Staff Cost	23,565	26,146	27,684	28,152	-1.7%	17.5%	5.9%
Other Expenditure	1,190	1,371	1,460	1,371	6.4%	22.7%	6.4%

Source: Company data, Morgan Stanley Research

Exhibit 2

Operating Margins Stable at F3Q10 Levels



Source: Company data, Morgan Stanley Research; E= Morgan Stanley Research Estimates



Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of March 31, 2010)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1042	41%	325	43%	31%
Equal-weight/Hold	1095	43%	348	46%	32%
Not-Rated/Hold	15	1%	4	1%	27%
Underweight/Sell	373	15%	87	11%	23%
Total	2,525		764		

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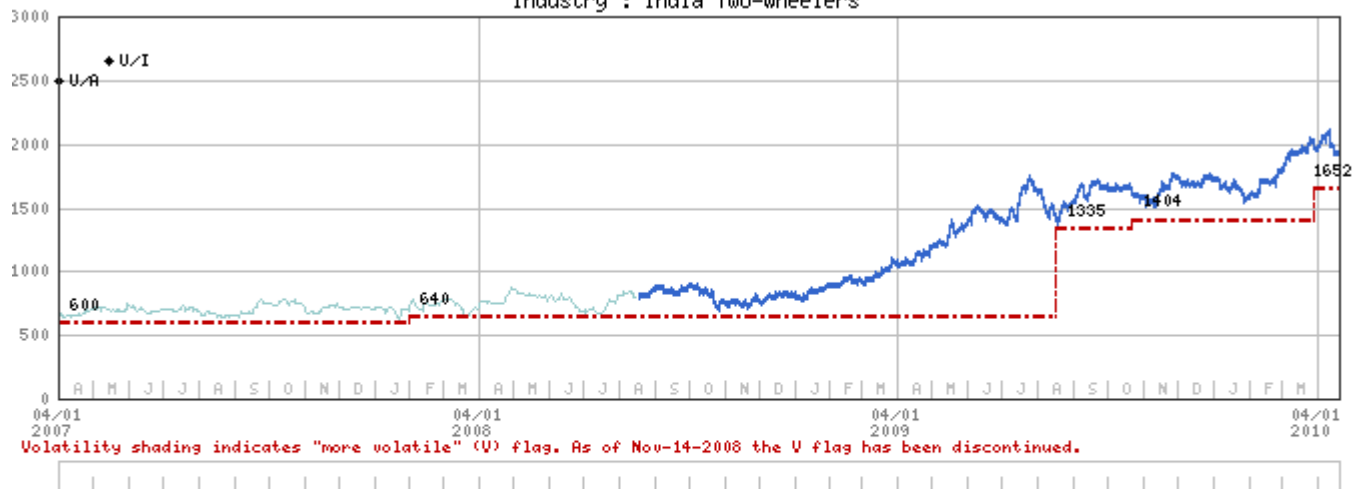
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Stock Price, Price Target and Rating History (See Rating Definitions)

Hero Honda Motor Ltd (HROH.BD) - As of 4/19/10 in INR
Industry : India Two-Wheelers



Stock Rating History: 4/1/07 : U/A; 5/15/07 : U/I

Price Target History: 7/11/06 : 600; 2/1/08 : 640; 8/17/09 : 1335; 10/22/09 : 1404; 3/29/10 : 1652

Source: Morgan Stanley Research Date Format: MM/DD/YY Price Target --- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (U) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

April 20, 2010
Hero Honda Motor Ltd

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Industry Coverage: India Two-Wheelers

Company (Ticker)	Rating (as of)	Price* (04/19/2010)
Binay Singh		
Bajaj Auto Ltd. (BAJA.BO)	E (04/15/2010)	Rs2,012.25
Hero Honda Motor Ltd (HROH.BO)	U (07/11/2006)	Rs1,896.9
TVS Motors (TVSM.BO)	E (05/15/2007)	Rs80.55

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