J.P.Morgan

Asia Pacific Equity Research
19 April 2010

Hero Honda

4QFY10 Results: PAT grows +49% yoy at Rs.5.98B - ALERT

Underweight

HROH.BO, HH IN
Price: Rs1,894.00

19 April 2010

Automobile Manufacture

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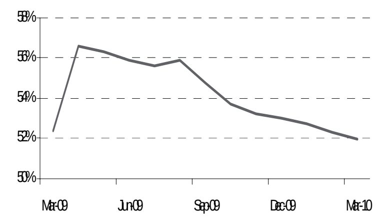
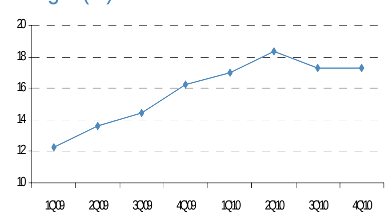
- Hero Honda 4Q PAT at Rs.5.98B (+49% yoy) was marginally above our estimates. The variance was led by better than expected EBITDA margins, (which improved by 110bp yoy, but were flat qoq) given increased localization content at the tax free Haridwar plant.
- **Hero Honda's sales grow lower than industry in 4Q:** Hero Honda's volume sales at +19% yoy were lower than industry growth rate of 37%. The company has been steadily ceding market share to competition and has lost 450bps market share (YTD) and over 800bp market share (on monthly basis) over 2HFY10. Product launches by Bajaj Auto in particular have resulted in the market share losses.
- **EBITDA margins flat qoq (+110bp yoy)**: Hero Honda's 4Q EBITDA margins at 17.3% benefited from lower raw material cost ratio (-120bp qoq) despite higher commodity costs, given higher localization levels at the tax exempt Uttarakhand unit (localization levels have improved from 45% earlier to 78% levels currently). However, increased promotional expenditure (towards the IPL tournament) resulted in higher other expenses (+120bp qoq) – which offset the impact of the above.
- **Tax rate decline led by higher proportion of units produced at the Uttarakhand unit**: Tax rates at 18.8% declined by -930bp yoy & -170bp qoq given increased proportion of production at the Haridwar plant. Over the quarter, the company produced 368,000 units and over FY10, the company produced 1.4m units from this unit. While the company will ramp up production from this unit to over 1.8m units in FY11E, the management expects FY11E tax rates to come in at c.19-20%, inline with 4Q levels.
- **Management guidance**: Post results, management highlighted that industry growth rates will moderate to trend levels of 12-15% over FY11E (significantly lower than the 24% growth in FY10), given a higher base effect and rising inflation. Management expects to grow inline with industry and will exceed 5m units in sales. The margins are expected to be lower at between 16-17% in FY11E, given rising commodity input costs. The decision on setting up the new plant will likely be taken over the next quarter.
- We believe that industry growth will likely moderate from here on and Hero Honda will face increased competitive pressures, given strong product line-up from the competition. Also, margins are likely to moderate on rising input costs and a potential build-up in competitive intensity. We re-iterate our underweight stance.

Figure 2: Hero Honda Motorbike market share (%)



Source: SIAM

Figure 2: Hero Honda Quarterly EBITDA margin (%)



Source: Company

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Table: Hero Honda 4QFY10 results Table

Rs. in Million	4Q FY09	4Q FY10	% chg	JP Morgan comments
	(Rs m)	(Rs m)	YoY	
2 wheelers (Nos)	997,855	1,186,536	19	While Hero Honda has benefited from strong industry growth over 4Q; the OEM's (+19% yoy) growth has come in lower than the industry (38% yoy) as competition has gained market share
Average realization (Rs/bike)	34,299	34,745	1.3	
Motorbikes (units)	948,366	1,120,086	18	
Scooters (units)	49,489	66,450	34	
Market share (Motorcycles %)	52.4	51.9		While the OEM has lost 40bps in market share yoy, Hero Honda has lost over 450bps in incremental market share over the past six months to competition (primarily to Bajaj Auto)
Market share (Overall %)	9.8	9.8		
	(Rs m)	(Rs m)		
Net sales	34,225	41,223	20	
Decrease/(Increase) in Stocks	86	(110)		
Raw Materials	23,479	27,794	17	RM Costs decreased by 150bp yoy & 120bp qoq despite higher commodity costs given that the localisation levels at the Uttarakhand unit have improved from 45% earlier to 78% currently
Staff costs	1,190	1,460	23	While Staff costs increased yoy, trend is inline with the current year
Other Expenses	3,980	4,962	25	Other expenses ratio increased 40bp yoy& 120bp qoq given higher advertising expenses on account of the IPL tournament
Total Expenditure	28,734	34,106	19	
Operating profit	5,491	7,117	30	Margins were flat qoq but increased +110bp yoy on lower raw material costs ratio
Interest	(96)	(45)	(54)	
Other income	442	695	57	Other income increased given higher cash surplus
Depreciation	444	487	10	While depreciation charge increased yoy, trend is inline with the current year
PBT	5,586	7,370	32	
Tax	1,564	1,382	(12)	Tax rate declined by 930bp yoy & 170bp qoq given increased proportion of production at the Haridwar plant
PAT	4,022	5,988	49	
PAT (pre exceptionals)	4,022	5,988	49	PAT growth was marginally (3%) ahead of estimates on higher than expected EBITDA margins
Profit Margins				
EBITDA Margin (%)	16.0	17.3	1.2	
Tax / PBT (%)	28.0	18.8	(9.3)	
Net profit margins (%)	11.8	14.5	2.8	
Cost ratios				
Raw materials / sales	68.9	67.2	(1.7)	
Staff costs / sales	3.5	3.5	0.1	
Other expenses / sales	11.6	12.0	0.4	
			-	
Equity (m shares)	199.7	199.7	-	
			-	
EPS (Rs)	20.1	30.0		

Source: Company, J.P. Morgan

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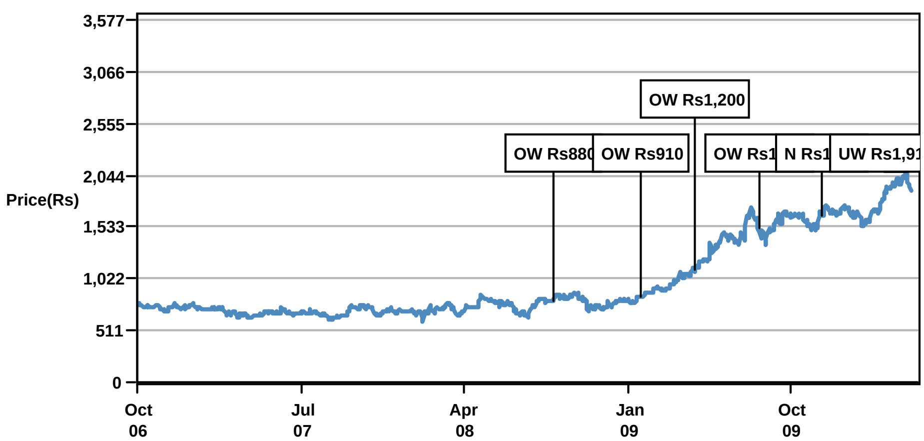
Hero Honda (HROH.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
28-Aug-08	OW	808.85	880.00
21-Jan-09	OW	834.05	910.00
22-Apr-09	OW	1100.90	1200.00
07-Aug-09	OW	1519.35	1680.00
22-Nov-09	N	1651.80	1710.00
13-Apr-10	UW	2085.95	1915.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage May 18, 2004 - Jun 29, 2004. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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