

# Hero Honda Motors

**Dipesh Sohani**

+91 22 67069933

dipesh\_sohani@investsmartindia.com

**Anukool Modak**

+91 22 67069915

Anukool.modak@investsmartindia.com

**Shareholding (%)**

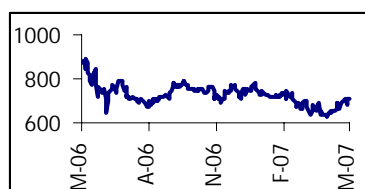
Promoters	55.0
FII's	27.8
Insurance Co.	5.9
Others	11.3

**Share price performance**

52-week high/low (Rs) 898/611			
	-1m	-3m	-12m
Abs (%)	10.1	-2.9	-19.1
Rel* (%)	4.6	-0.3	-29.2

\*to Nifty

**Stock chart**



**Topline exceeds expectations; margin continues to disappoint**

Hero Honda Motors Ltd. (HHML) has reported topline growth of 17% in Q4FY07 on the back of 11% volume growth. The company's EBDITA in absolute terms saw a substantial decline by 26% at Rs2,686.6mn, while net profit was down 27% at Rs1,950mn. HHML's performance was impacted by rising raw material cost and other expenses. Promotional expenses incurred by the company across product variants also impacted overall profitability.

**Key highlights**

- ▲ HHML's sales for the quarter increased 17% YoY to Rs26.39bn (down one percent QoQ) due to 11% YoY growth in volume. For the year ended 2007, sales was up 14% on account of volume growth of 11.2%. The company sold 3.33mn units against 3mn the last year. Also, HHML improved its market share by 49.2% in FY07.
- ▲ HHML's EBITDA margin for the Q4, dropped by a whopping 590bps YoY and 110bps QoQ. The company's profit margin was impacted by rising proportion of raw material cost to sales, which increased by 500bps YoY; though it dropped by 100bps QoQ to 73%. Consequently, EBDITA was down 26% YoY at Rs2,686.6mn from Rs3,631.9mn. For FY07, margin was down by 390bps at 11.8%.
- ▲ The ratio of other expenses to sales increased by 100bps YoY due to higher promotional expenditure. The company has launched about eight new products, including variants. These efforts require significant brand building and promotional expenses.
- ▲ Net profits dropped 27% YoY to Rs1.95bn (down 7% QoQ) for Q4FY07. On full-year basis, net profit was down 12% at Rs8.57bn.

**Aggressive product launches**

- ▲ In FY07, HHML launched eight products across of the segments, which were able to continue the momentum. It includes the likes of *CBZ x-treme*, *New Karizma*, *Glamour FI*, *Glamour with alloy wheels*, *CD Deluxe*, *CD Dawn*, *Passion Plus*, *New Achiever with alloy wheel*.

**Hold**

**Rs705**

May 11, 2007

**Market cap**

Rs bn 141

US\$ bn 3

**Avg 3m daily volume**

333,280

**Avg 3m daily value**

USD mn 6

**Shares outstanding (mn)**

200

**Reuters**

HROH.BO/HEROHONDA.NS

**Bloomberg**

HH IN

**Sensex**

13,796

**Nifty**

4,077

## Hero Honda Motors

### Consolidating its position in premium segment

The company launched *CBZ X-treme* in October 2006; it was a offering in premium segment. this variant has received encouraging market response and is likely to facilitate HHML in consolidating and gaining market share in the premium segment.

### Valuation

With 11% volume growth in motor cycles, HHML has underperformed the industry's growth level of 13% for FY07. Though, during the quarter, the company regained its market share lost to rival Bajaj Auto Ltd. We believe that as a leading player in the domestic two-wheeler market, HHML would continue to remain exposed to intensifying competition from existing and new players.

HHML's performance would depend on the success of its recently launched products going forward. The company is likely to adhere to its strategy of introducing new variants through application of new technologies. However, HHML's margins may continue to remain under pressure, with the impact of rising raw material prices and other expenses on the company's overall profitability. At the current prices, the stock discounts our FY09 earnings estimates by about 14.1x. We maintain 'Hold' rating on the stock.

## Hero Honda Motors

Table 1. Quarterly result table

Rs mn	Q4FY07	Q4FY06	YoY (%)	Q3FY07	QoQ (%)	FY07	FY06	YoY (%)
Net Sales	26,395.8	22,558.8	17%	26,660.0	-1%	98999.6	87,139.8	14%
Total Expenses	23,709.2	18,926.9	25%	23,641.3	0%	87,269.2	73,459.8	19%
Inc / Dec in stock	113.0	87.0	30%	873.3	-87%	22.4	(149.7)	-115%
Raw material consumed	19,177.4	15,307.4	25%	18,755.7	2%	71,764.7	60,672.7	18%
Empolyee cost	904.5	821.4	10%	917.4	-1%	3,538.1	3,206.1	10%
Other Expenses	3,514.3	2,711.1	30%	3,094.9	14%	11,944.0	9,730.7	23%
EBIDTA	2,686.6	3,631.9	-26%	3,018.7	-11%	11,730.4	13,680.0	-14%
Other Income	445.1	430.3	3%	335.8	33%	1,898.5	1,527.3	24%
PBIDT	3,131.7	4,062.2	-23%	3,354.5	-7%	13,628.9	15,207.3	-10%
Interest	(76.9)	(39.3)	96%	(55.1)	40%	(229.9)	(61.3)	275%
Gross Profit	3,208.6	4,101.5	-22%	3,409.6	-6%	13,858.8	15,268.6	-9%
Depreciation	355.1	304.7	17%	375.8	-6%	1,397.8	1,146.2	22%
PBT	2,853.5	3,796.8	-25%	3,033.8	-6%	12,461.0	14,122.4	-12%
Tax	903.5	1,124.9	-20%	942.5	-4%	3,882.1	4,409.0	-12%
PAT	1,950.0	2,671.9	-27%	2,091.3	-7%	8,578.9	9,713.4	-12%
Extraordinary items	-	-		-		-	-	
Adjusted Net profit	1,950.0	2,671.9	-27%	2,091.3	-7%	8,578.9	9,713.4	-12%
Equity	399.4	399.4		399.4		399.4	399.4	
EPS	9.8	13.4		10.5		43.0	48.6	
<b>Key Ratios (%)</b>								
EBIDTA Margin	10.2	16.1		11.3		11.8	15.7	
Interest / Sales	(0.3)	(0.2)		(0.2)		(0.2)	(0.1)	
Tax / PBT	31.7	29.6		31.1		31.2	31.2	
NPM	7.4	11.8		7.8		8.7	11.1	

Source: IISL research, company

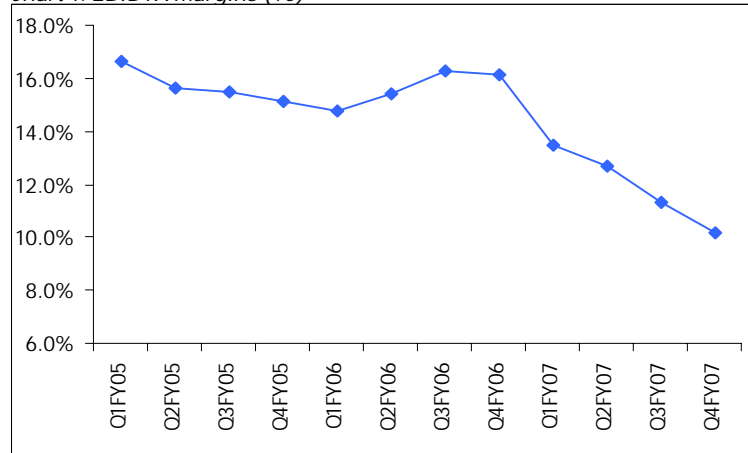
Table 2. Estimates

Rs. Mn	FY06	FY07	FY08E	FY09E
Net Sales	87,082	99,000	107,415	118,156
% change		13.7%	8.5%	10.0%
EBIDTA	15,298	11,730	10,741	12,997
% change		-23.3%	-8.4%	21.0%
EBIDTA margins	17.6%	11.8%	10.0%	11.0%
PAT	9,103	8,579	8,701	10,043
% change		-5.8%	1.4%	15.4%
PAT margins	10.5%	8.7%	8.1%	8.5%
EPS	45.6	43.0	43.6	50.3
% change		-5.8%	1.4%	15.4%
P/E(x)	15.5	16.4	16.2	14.0
Equity	399.4	399.4	399.4	399.4

Source: IISL research, company

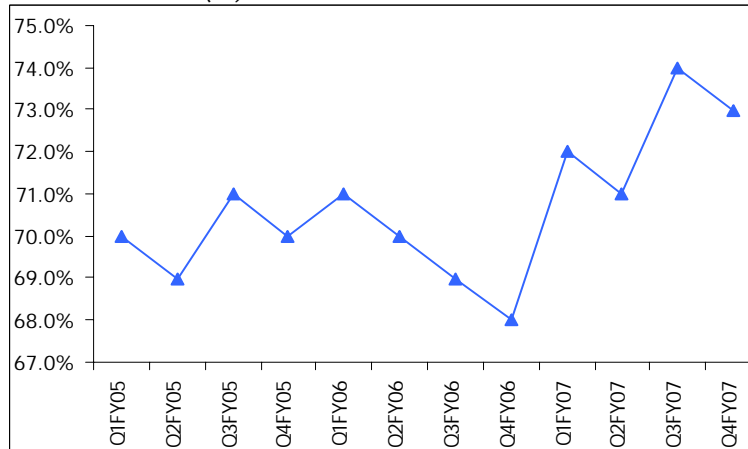
# Hero Honda Motors

Chart 1. EBITDA margins (%)



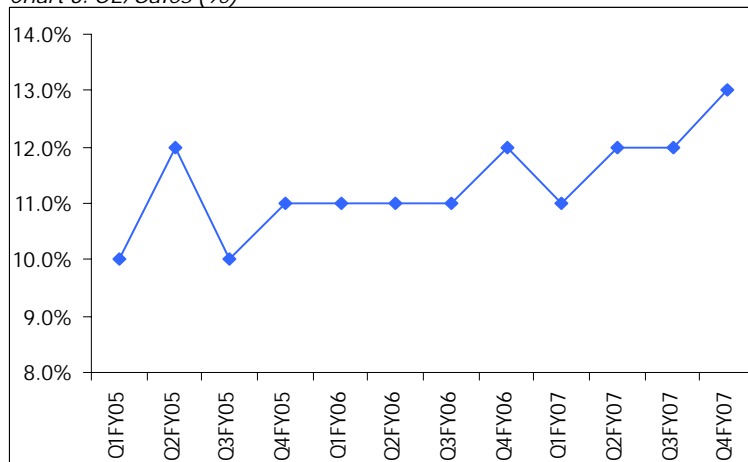
Source: IISL research, company

Chart 2. RM/Sales (%)



Source: IISL research, company

Chart 3. OE/Sales (%)



Source: IISL research, company

## Disclaimer Clause

This report has been prepared by the Research Department of IL&FS Investsmart Securities Limited (IISL). The information and opinions contained herein have been compiled or arrived at based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This report has been produced independently of the company, and forward looking statements, opinions and expectations contained herein are entirely those of IISL and given as part of its normal research activity and not as a Manager or Underwriter or any Offering or as an agent of the Company or any other person. Accordingly, if the Company should at any time commence an Offering of securities, any decision to invest in any such Offer or invitation to subscribe for or acquire securities of the Company must be based wholly on the information contained in the Final Prospectus issued or to be issued by the Company in connection with any such Offer or invitation and not on the contents hereof. This document is for information purpose only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. IISL, its directors, analysts or employees do not take any responsibility financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of the shares and bonds, changes in the currency rates, diminution in the NAVs reduction in the dividend or income, etc

IISL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.

This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject IISL or its affiliates to any registration or licensing requirement within such jurisdiction. If this report is inadvertently send or has reached any individual in such country, especially, USA the same may be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published for any purpose without prior written approval of IISL.

Foreign currency denominated securities, if any, wherever mentioned are subject to exchange rate fluctuations which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk.