

Hero Honda

Rating: ◀▶

Target price: ▼

EPS: ▼

CMP	Rs. 1,561	Absolute	Reduce
Target	Rs. 1,613	Relative	Underperform

Volume growth in sight, pressure on profitability exist

Revenue grew by 13% qoq driven by 11% growth in volume and 2% growth in average realisation. EBITDA margin declined by 219bps qoq and adjusted PAT grew by 0.6% to Rs. 5.08bn. Adjusting for one time expenses relating to Rs. 380mn towards Common Wealth Games and Rs. 300mn of customs and excise duties on NCCD and Education cess for the period Apr-Sep FY11, the EBITDA margin was at 12.5%, against our estimate of 12.6%. The company had an exceptional item to the extent of Rs. 798.4mn towards customs and central excise on NCCD and Education cess on sales from the Haridwar plant for the period Apr08-Dec09.

While the one-time expenses will be non-existent in 4QFY11, we continue to expect RM cost inflation to negatively impact gross margin to the extent of 30bps on a sequential basis. Also 4QFY11 is expected to have higher other expenses on the back of sponsorship expenses for the upcoming Cricket World Cup and IPL expenses in 1QFY12

Raw material cost inflation was not completely passed on during the quarter and expect this situation to continue in the ensuing quarter. We believe building new product capabilities will take time and thus expect Hero Honda to focus on volume growth at the cost of profitability in the next fiscal. For FY12, we expect volumes to grow by 14% to 6.0mn units and expect EBITDA margin to decline by 40bps to 12.1%. Accordingly, we expect PAT to grow by 13% to Rs. 115.2.

Continue to prefer Bajaj Auto over Hero Honda

We believe Bajaj's ability to grow profitably with growth in three-wheelers and exports would ensure better earnings growth vs. Hero Honda. We expect Bajaj Auto to grow at a CAGR of 28% for FY10-12E to Rs. 30bn against Hero Honda's CAGR of 1.5% to Rs. 23.0bn for the same period and continue to reiterate our preference of Bajaj Auto over Hero Honda. We continue to assign exit multiple 15x PE multiple for Bajaj Auto vs, Hero Honda at 14x. We continue to rate the stock Reduce-Underperform at our target price of Rs. 1,613.

Other key highlights of the result

- Average realisation grew by 2.1% qoq against 3.8% increase in RM per vehicle
- Effective tax rate, ignoring the exceptional time, was at 13.4% for the quarter
- Rs. 500-1,500 price increase per bike in Dec 2010, may not completely offset the cost pressure

Financial summary

Year	Revenues (Rs. mn)	EBITDA (Rs. mn)	Adj. PAT (Rs. mn)	Adj. EPS (Rs.)	P/E(x)	EV/EBITDA(x)
FY10	158,312	27,670	22,318	111.8	14.0	11.2
FY11E	192,589	24,064	20,314	101.7	15.3	12.6
FY12E	226,138	27,363	23,002	115.2	13.6	10.5

3QFY11 Update

Date: Feb 03, 2011

Market Data

SENSEX	18090
Nifty	5432
Bloomberg	HH IN
Shares o/s	504mn
Market Cap	Rs. 311.7bn
52-wk High-Low	Rs. 2,094-1,535
3m Avg. Daily Vol	Rs.1,495mnn
Index member	Sensex

Latest shareholding (%)

Promoters	52.2
Institutions	38.0
Public	9.8

Stock performance (%)

	1m	3m	12m
HH	-23.3	-18.5	-1.0
Sensex	-12.0	-11.6	9.7
BSE Auto	-15.5	-14.3	21.8

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Hero Honda

Quarterly Financial Results

CMP	Rs. 1,561	Absolute	Reduce
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Standalone financial results								
Rs. mn\Period	31-Dec-10	31-Dec-09	yoy Growth	30-Sep-10	qoq Growth	FY11E	FY12E	yoy Growth
Revenue	51,617	38,270	34.9%	45,520	13.4%	192,589	226,138	17.4%
Raw Material	38,149	26,146	45.9%	33,100	15.3%	140,788	165,307	17.4%
Employee cost	1,561	1,371	13.8%	1,498	4.2%	6,084	7,236	18.9%
Other cost	6,141	4,144	48.2%	4,842	26.8%	21,654	26,232	21.1%
Total Expenditure	45,851	31,661	44.8%	39,440	16.3%	168,525	198,776	18.0%
EBITDA	5,766	6,609	-12.8%	6,079	-5.2%	24,064	27,363	13.7%
Margin %	11.2%	17.3%	-610 bps	13.4%	-219 bps	12.5%	12.1%	-40 bps
Depreciation	560	469	19.3%	608	-7.9%	2,260	2,350	4.0%
EBIT	5,206	6,140	-15.2%	5,472	-4.9%	21,804	25,013	14.7%
Other income	620	550	12.9%	784	-20.8%	2,583	2,600	0.7%
Net Interest exp (inc)	-52	-46	13.7%	-21	152.2%	-125	-100	-19.7%
PBT	5,080	6,736	-24.6%	6,276	-19.1%	24,512	27,713	13.1%
Tax provision	790	1,378	-42.6%	1,220	-35.2%	4197	4711	12.2%
Tax rate %	15.6%	20.5%	-490 bps	19.4%	-388 bps	17.1%	17.0%	-12 bps
PAT (Reported)	4,290	5,358	-19.9%	5,056	-15.2%	20,314	23,002	13.2%
PAT (Adjusted)	5,088	5,358	-5.0%	5,056	0.6%	20,314	23,002	13.2%
Adjusted PAT Margin	9.9%	14.0%	-414 bps	11.1%	-125 bps	10.5%	10.2%	-38 bps
Shares Outstanding	200	200		200		200	200	
EPS (Reported)	21.5	26.8	-19.9%	25.3	-15.2%	101.7	115.2	13.2%
EPS (Adjusted)	25.5	26.8	-5.0%	25.3	0.6%	101.7	115.2	13.2%

Hero Honda

Business Overview

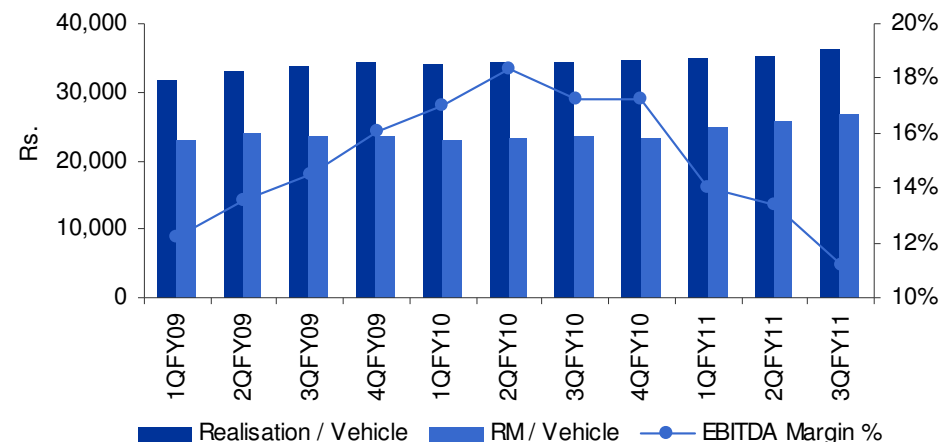
CMP	Rs. 1,561	Absolute	Reduce
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Key estimate revision

	FY11E			FY12E		
	Old	New	Change	Old	New	Change
Revenue	189,512	192,589	1.6%	222,525	226,138	1.6%
EBITDA	25,655	24,064	-6.2%	31,153	27,363	-12.2%
Margin (%)	13.5%	12.5%	-104 bps	14.0%	12.1%	-190 bps
PAT	20,945	20,314	-3.0%	25,266	23,002	-9.0%
PAT Margin	11.1%	10.5%	-50 bps	11.4%	10.2%	-118 bps
EPS	104.9	101.7	-3.0%	126.5	115.2	-8.9%

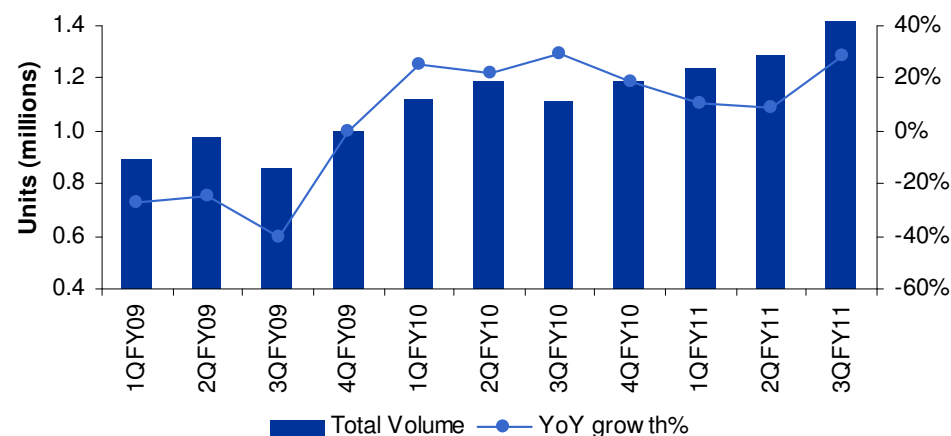
All figures in Rs. mn, except EPS, which is in Rs.

Average realisation, RM per vehicle and EBITDA margin



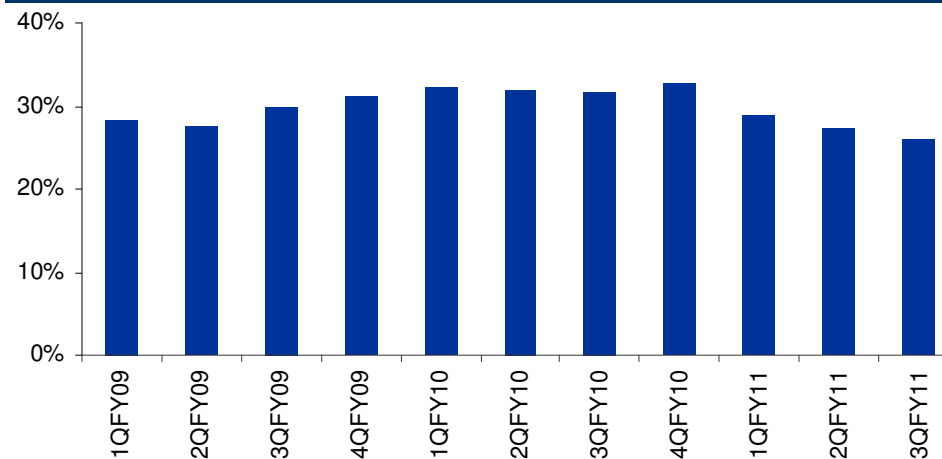
Source: Company, Spark Capital

Volume trend



Source: Company, Spark Capital

Gross margin



Source: Company, Spark Capital

Hero Honda

Financial Summary

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Abridged Financial Statements				
Rs. mn	FY09	FY10	FY11E	FY12E
Profit & Loss				
Revenues	123,191	158,312	192,589	226,138
Manufacturing & Other Expenses	106,094	130,643	168,525	198,776
EBITDA	17,097	27,670	24,064	27,363
Depreciation	1,807	1,915	2,260	2,350
EBIT	15,291	25,755	21,804	25,013
Net Interest Exp / (inc)	(317)	(206)	(125)	(100)
Profit Before Tax	17,815	28,317	24,512	27,713
Tax	4,997	5,999	4,197	4,711
Adj. Net Profit	12,818	22,318	20,314	23,002
Balance Sheet (Rs. mn)				
Shareholders Equity	38,008	34,650	47,955	63,947
Loan funds	785	660	541	541
SOURCES OF FUNDS	40,237	36,838	50,161	66,153
Net block	15,737	16,588	18,309	17,941
Investments	33,688	39,257	41,257	43,257
Capital WIP	1,205	481	481	481
Current assets, loans & advances	10,135	12,851	28,331	48,028
Current liabilities & provisions	20,528	32,339	38,217	43,554
Net Current Assets	(10,393)	(19,488)	(9,887)	4,474
APPLICATION OF FUNDS	40,237	36,838	50,161	66,153
Cash Flows (Rs. mn)				
Cash flow s from operations	17,140	26,866	20,802	27,208
Capex	(3,262)	(2,101)	(3,981)	(1,981)
Free cashflow	13878	24766	16820	25226
Cash flow s from investments	(11,281)	(5,276)	(5,981)	(3,981)
Cash flow s from financing	(4,974)	(21,093)	(9,820)	(7,009)
Cash generated during the year	(21)	497	5,001	16,217

Key metrics				
	FY09	FY10	FY11E	FY12E
Growth ratios				
Revenues	19.2%	28.5%	21.7%	17.4%
EBITDA	26.7%	61.8%	-13.0%	13.7%
PAT	32.4%	74.1%	-9.0%	13.2%
Margins				
EBITDA	13.9%	17.5%	12.5%	12.1%
EBIT	12.4%	16.3%	11.3%	11.1%
PAT	10.4%	14.1%	10.5%	10.2%
Leverage & WC ratios				
Debt to equity (x)	0.0	0.0	0.0	0.0
Current ratio (x)	0.5	0.4	0.7	1.1
Debtor days (Sales)	11	7	3	5
Inventory days (COGS)	15	13	13	25
Creditor Days (COGS)	32	30	31	40
Performance & turnover ratios				
RoACE	30.3%	52.7%	41.5%	35.7%
RoAE	37.8%	61.4%	49.2%	41.1%
Total asset turnover (x)	2.7	3.3	3.5	3.1
Fixed asset turnover (x)	5.5	6.0	6.5	7.0
Valuation metrics				
Current price (Rs.)	1,561			
Shares outstanding (mn)	200	200	200	200
Market capitalisation (Rs. mn)	311,772	311,772	311,772	311,772
Enterprise value (Rs. mn)	310,361	309,335	304,215	287,998
EV/EBITDA (x)	18.2	11.2	12.6	10.5
Per-share earnings (Rs.)	64.2	111.8	101.7	115.2
Price-earnings multiple (x)	24.3	14.0	15.3	13.6
Dividend yield (%)	1.3%	1.9%	1.9%	1.9%

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Absolute Rating Interpretation

BUY	Stock expected to provide positive returns of > 15% over a 1-year horizon
ADD	Stock expected to provide positive returns of <=15% over a 1-year horizon
REDUCE	Stock expected to fall <=15% over a 1-year horizon
SELL	Stock expected to fall >15% over a 1-year horizon

Relative Rating Interpretation

OUTPERFORM	Stock expected to outperform sector index /sector peers in our coverage
UNDERPERFORM	Stock expected to underperform sector index/ sector peers in our coverage

Recommendation History

Date	CMP	Target price	Absolute Rating	Relative Rating
10-Jan-11	1,880	1,771	Reduce	UPF
14-Dec-10	1,774	1,771	Reduce	UPF
01-Nov-10	1,866	1,771	-	NTL
08-Oct-10	1,844	1,873	-	NTL
02-Aug-10	1,825	1,873	-	NTL

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