

Hero Honda Motors

HOLD**Maintained****Rs1,613**

Great pick-up

Reason for report: Q2FY10 results review

Hero Honda Motors' (HHML) Q2FY10 recurring net income grew a strong 95% YoY to Rs5.98bn (I-Sec: Rs5bn) owing to EBITDA margin expansion and lower tax rate. HHML's revenues grew 26.8% YoY to Rs40.5bn, led by strong volume growth of 21.7% – 45.7% YoY growth in scooters and 20.8% YoY in motorcycles. Margin growth was owing to operational leverage and benefits from the Uttaranchal plant. Going forward, we expect profitability to be under pressure with increasing raw material cost and decline in volume growth due to lower monsoons as harvest season nears. We believe the stock is fairly valued at FY11E P/E of 14.8x. HOLD.

- **Volume growth drives revenues.** HHML's revenues grew 26.8% YoY to Rs40.6bn (I-Sec: Rs40.4bn) led by 21.7% YoY volume growth (45.7% YoY in scooters and 20.8% YoY in motorcycles). The company gained 260bps YoY market share in motorcycles to 60.4% and 310bps YoY in scooters to 15.1%. Blended realisation marginally rose 0.4% QoQ on stable product mix and lack of pricing action, although YoY realisation improved on better product mix (the share of executive and premium segment bikes rose 140bps YoY to 85.8%).
- **EBITDA margin expanded 470bps YoY to 18.3%** led by: i) lower raw material cost (raw material-to-sales lower 430bps YoY), ii) operating leverage, iii) better product mix towards executive and premium segments and iv) higher share of *Splendor* bikes from the Uttaranchal plant, where HHML enjoys excise duty benefits. However, raw material costs were 30bps higher QoQ due to increase in metal prices. Other income increased 27.5% YoY to Rs687mn, resulting in 70.6% YoY growth in recurring pre-tax income. Tax rate was lower at 22.3%, leading to recurring net income growing 95% YoY to Rs5.97bn (I-Sec: Rs5bn).
- **Maintain HOLD.** HHML continues to maintain leadership in the domestic two-wheeler market, increasing its market share. Profitability has improved on account of high volume growth and operational benefits from the Uttaranchal plant, but increasing raw material costs would pressurise margins further. Also, effect of lower monsoons on farm income would affect rural sales growth post Q3FY10. HHML is currently trading at rich valuations of FY11E P/E of 14.8x. Maintain HOLD.

Market Cap	Rs322bn/US\$6.9bn
Reuters/Bloomberg	HROH.BO/HH IN
Shares Outstanding (mn)	200
52-week Range (Rs)	1780/661
Free Float (%)	45.0
FII (%)	28.5
Daily Volume (US\$'000)	19,550
Absolute Return 3m (%)	(0.4)
Absolute Return 12m (%)	98.4
Sensex Return 3m (%)	14.6
Sensex Return 12m (%)	67.2

Year to March	FY08	FY09	FY10E	FY11E
Revenue (Rs mn)	103,318	123,199	138,620	156,832
Net Income (Rs mn)	9,679	12,553	17,477	21,826
EPS (Rs)	48.5	62.9	87.5	109.3
% Chg YoY	12.8	29.7	39.2	24.9
P/E (x)	33.3	25.7	18.4	14.8
CEPS (Rs)	56.5	71.9	98.5	121.5
EV/E (x)	22.1	16.9	12.2	9.4
Dividend Yield (%)	1.2	1.2	1.4	1.6
RoCE (%)	32.3	34.6	37.5	35.8
RoE (%)	35.5	37.0	39.7	37.7

Automobiles

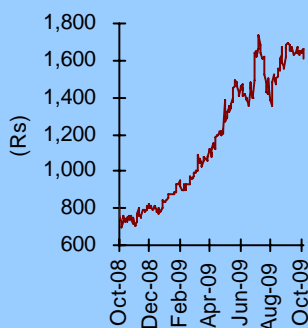
Target price Rs1,650

Shareholding pattern

	Mar '09	Jun '09	Sep '09
Promoters	55.0	55.0	55.0
Institutional investors	36.6	36.7	36.7
MFs and UTI	4.7	4.0	3.9
Insurance Cos.	4.8	4.2	4.3
FIs	27.0	28.6	28.5
Others	8.4	8.3	8.3

Source: www.nseindia.com

Price chart

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Table 1: Q2FY10 results review (standalone)

(Rs mn, year ending March 31)

	Q2FY10	Q2FY09	% YoY	Q1FY10	% QoQ	H1FY10	H1FY09	% chg
Net Sales	40,594	32,021	26.8	38,224	6.2	80,267	60,531	32.6
(Inc)/Dec in Stock	(50)	(832)	(94.0)	124	(140.0)	75	(995)	(107.5)
Raw Materials	27,686	24,015	15.3	25,773	7.4	53,459	44,631	19.8
Staff Cost	1,387	1,103	25.8	1,385	0.1	2,772	2,142	29.4
Other Expenditure	4,130	3,386	22.0	4,441	(7.0)	8,571	6,918	23.9
Total Expenses	33,153	27,672	19.8	31,723	4.5	64,876	52,697	23.1
EBITDA	7,442	4,349	71.1	6,501	14.5	15,391	7,834	96.4
Interest	(61)	(83)	(26.9)	(55)	11.7	(116)	(133)	(13.1)
Depreciation	503	466	7.9	456	10.4	959	888	8.0
Other Income	687	539	27.5	425	61.7	1,112	931	19.4
EBIT	7,625	4,421	72.5	6,470	17.9	15,543	7,877	97.3
Recurring pre-tax income	7,686	4,505	70.6	6,525	17.8	15,659	8,010	95.5
Ext. Ord Inc/(Exp)								
Taxation	1,715	1,442	19.0	1,524	12.6	3,239	2,218	46.0
Reported Net Income	5,971	3,063	95.0	5,001	19.4	12,420	5,792	114.4
Recurring Net Income	5,971	3,063	95.0	5,001	19.4	12,420	5,792	114.4
Ratios (%)								
RM/Sales	68.1	72.4		67.7		66.7	72.1	
Staff Cost/Sales	3.4	3.4		3.6		3.5	3.5	
Other Expenses/Sales	10.2	10.6		11.6		10.7	11.4	
EBIDTA Margins	18.3	13.6		17.0		19.2	12.9	
Net profit margins	14.7	9.6		13.1		15.5	9.6	
Effective Tax Rate	22.3	32.0		23.4		20.7	27.7	

Source: Company data, I-Sec Research

Table 2: Sales volumes – Three-wheelers lead growth

(Nos)

	Q2FY10	Q2FY09	% YoY	Q1FY10	% QoQ	H1FY10	H1FY09	% chg
Motorcycles	1,128,515	934,527	20.8	1,071,816	5.3	2,200,331	1,803,303	22.0
Scooters	54,720	37,568	45.7	47,171	16.0	101,891	63,036	61.6
Total Volumes	1,183,235	972,095	21.7	1,118,987	5.7	2,302,222	1,866,339	23.4
Market share (%)								
Motorcycles	60.4	57.8		62.1		62.1	57.5	
Scooters	15.1	12.0		14.5		14.5	10.8	

Source: Company data, I-Sec Research

Financial Summary

Table 3: Profit and Loss statement
(Rs mn, year ending March 31)

	FY08	FY09	FY10E	FY11E
Operating Income (Sales)	103,318	123,199	138,620	156,832
Operating Expenses	89,824	106,094	115,955	129,286
EBITDA	13,494	17,105	22,665	27,546
% margins	13.1	13.9	16.4	17.6
Depreciation & Amortisation	1,603	1,807	2,189	2,445
Gross Interest	20	25	30	30
Other Income	2,232	2,277	3,013	3,838
Recurring PBT	14,103	17,550	23,459	28,909
Add: Extraordinaries	-	-	-	-
Less: Taxes	4,424	4,997	5,982	7,083
- Current tax	4,412	4,947	5,865	6,938
- Deferred tax	12	50	117	145
Net Income (Reported)	9,679	12,553	17,477	21,826
Recurring Net Income	9,679	12,553	17,477	21,826

Source: Company data, I-Sec Research

Table 4: Balance sheet
(Rs mn, year ending March 31)

	FY08	FY09	FY10E	FY11E
Assets				
Total Current Assets	9,528	10,135	11,573	12,774
of which cash & cash eqv.	1,311	2,196	2,185	2,218
Total Current Liabilities & Provisions	18,247	20,528	22,238	25,149
Net Current Assets	(8,719)	(10,393)	(10,665)	(12,374)
Investments				
of which	25,668	33,688	45,535	63,535
Strategic/Group	35	35	35	35
Other Marketable	25,634	33,653	45,500	63,500
Net Fixed Assets	15,487	16,943	18,253	17,808
of which				
Capital Work-in-Progress	3,924	1,205	300	300
Total Assets	32,436	40,237	53,123	68,968
Liabilities				
Borrowings	1,320	785	1,450	1,450
Deferred Tax Liability	1,254	1,444	1,562	1,706
Equity Share Capital	399	399	399	399
Face Value per share (Rs)	2	2	2	2
Reserves & Surplus*	29,463	37,608	49,712	65,412
Net Worth	29,862	38,008	50,111	65,812
Total Liabilities	32,436	40,237	53,123	68,968

*excluding revaluation reserves; # not written-off

Source: Company data, I-Sec Research

Table 7: Quarterly trend
(Rs mn, year ending March 31)

	Dec-08	Mar-09	Jun-09	Sep-09
Net sales	28,813	34,225	38,224	40,594
% growth (YoY)	5.0	22.7	34.1	26.8
EBITDA	4,170	5,491	6,501	7,442
Margin (%)	14.5	16.0	17.0	18.3
Other income	436	442	425	687
Extraordinaries Inc / (Loss)	-	-	-	-
Recurring Net Income	3,004	4,022	5,001	5,971

Source: Company data

Table 5: Cashflow statement
(Rs mn, year ending March 31)

	FY08	FY09	FY10E	FY11E
Operating Cash flow	9,518	12,339	17,537	21,626
Working Capital Changes	3,388	2,287	(505)	694
Capital Commitments	(3,407)	(3,056)	(3,500)	(2,000)
Free Cash Flow	9,499	11,570	13,531	20,320
Cash flow from Investing Activities	(3,697)	(5,742)	(8,834)	(14,162)
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	(332)	(535)	665	-
Dividend paid	(4,439)	(4,673)	(5,373)	(6,126)
Extraordinary Items	-	-	-	-
Chg. in Cash & Bank balance	953	885	(11)	33

Source: Company data, I-Sec Research

Table 6: Key ratios
(Year ending March 31)

	FY08	FY09	FY10E	FY11E
Per Share Data (Rs)				
EPS(Basic Recurring)	48.5	62.9	87.5	109.3
Diluted Recurring EPS	48.5	62.9	87.5	109.3
Recurring Cash EPS	56.5	71.9	98.5	121.5
Dividend per share (DPS)	19.0	20.0	23.0	26.2
Book Value per share (BV)	149.5	190.3	250.9	329.6
Growth Ratios (%)				
Operating Income	4.4	19.2	12.5	13.1
EBITDA	15.0	26.8	32.5	21.5
Recurring Net Income	12.8	29.7	39.2	24.9
Diluted Recurring EPS	12.8	29.7	39.2	24.9
Diluted Recurring CEPS	13.1	27.3	37.0	23.4
Valuation Ratios (x)				
P/E	33.3	25.7	18.4	14.8
P/CEPS	28.6	22.4	16.4	13.3
P/BV	10.8	8.5	6.4	4.9
EV / EBITDA	22.1	16.9	12.2	9.4
EV / Operating Income	2.9	2.3	2.0	1.7
EV / Operating FCF	23.1	19.7	16.3	11.6
Operating Ratio				
Raw Material/Sales (%)	72.3	71.5	69.4	68.3
SG&A/Sales (%)	4.9	4.7	4.6	4.6
Other Income / PBT (%)	15.8	13.0	12.8	13.3
Effective Tax Rate (%)	31.4	28.5	25.5	24.5
NWC / Total Assets (%)	(110.0)	(114.9)	(109.8)	(113.2)
Inventory Turnover (days)	25.4	27.6	27.8	27.6
Receivables (days)	9.6	6.0	4.1	4.3
Payables (days)	32.0	30.2	28.4	28.6
D/E Ratio (x)	8.6	5.9	6.0	4.8
Return/Profitability Ratio (%)				
Recurring Net Income Margins	9.4	10.2	12.6	13.9
RoCE	32.3	34.6	37.5	35.8
RoNW	35.5	37.0	39.7	37.7
Dividend Payout Ratio	45.9	37.2	30.7	28.1
Dividend Yield	1.2	1.2	1.4	1.6
EBITDA Margins	13.1	13.9	16.4	17.6

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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