



Hero Honda - ADD

Autos

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GST to help maintain vehicle prices; Uttaranchal plant to help maintain margins

Hero Honda was represented by Surender Chhabra at IIFL's Enterprising India Investors' Conference. Here are key takeaways from the presentation.

No price war in the offing: Both Hero Honda and Bajaj clearly stated at IIFL's Enterprising India Investors' Conference that they have learnt their lesson from the FY07 price war and are now unwilling to engage in such tactics, as they do not help any manufacturer.

Increased benefits from Uttaranchal plant to help combat rise in commodity prices; margins to stabilise at 16% levels: Management said production from the Uttaranchal plant is likely to cross 1.3m units in FY10. With a third line being added in February, production is likely to cross 1.8m units in FY11. Increased benefits from the Uttaranchal plant are likely to help the company offset the adverse impact of increases in commodity prices. The increase in production at Uttaranchal is likely to bring down the tax rate further to 19-20%.

Discussing with Honda the possibility of exporting to African markets: Hero Honda is not allowed to export to most large motorcycle markets, as Honda has its own assembly units there. Honda has no assembly unit in Africa. Honda does have presence in Africa, but only in the higher-cc segments, whereas more than 95% of the bikes sold in Africa are 100cc models (Chinese manufacturers have ~75% market share). Bajaj has made inroads into the market in the last 2-3 years and has managed to corner 25% share of the market. Given Hero Honda's strength in 100cc markets and its low-cost structure, we believe it makes for a strong case for Honda to allow exports to Africa from Hero Honda. If Honda agrees, this could be a big opportunity for Hero Honda.

CMP	Rs1584	Price performance (%)			
12-mth Target price (Rs)	1850	1M	3M	1Y	
Market cap (US\$ m)	6768	Hero Honda	-3.7	3.6	80.0
Bloomberg	HH IN	Rel. to Sensex	6.4	5.1	8.9
52Wk High/Low (Rs)	1809/872	Bajaj Auto	4.0	18.3	278.4
Diluted o/s shares (m)	200	TVS Motor	3.2	18.2	284.1
Daily volume (US\$ m)	18	Maruti	-4.2	-6.6	137.8
Dividend yield FY10ii (%)	0.4	Stock Performance			
Free float (%)	45.0	Shares (000') (Rs)			
Shareholding pattern (%)					
Promoters	55.0				
FII's	28.8				
DII's	7.8				
Public	8.4				

Financial Summary					
Y/e 31 Mar	FY08A	FY09A	FY10ii	FY11ii	FY12ii
Revenues (Rs m)	103,318	123,191	156,176	179,280	205,801
EBITDA Margins (%)	13.1	13.9	17.2	16.1	16.3
Reported PAT (Rs m)	9,679	12,818	21,834	23,780	27,589
EPS (Rs)	48.5	64.2	109.3	119.1	138.2
Growth (%)	12.8	32.4	70.3	8.9	16.0
PER (x)	32.6	24.6	14.4	13.3	11.4
ROE (%)	35.5	37.8	47.5	37.8	33.3
Debt/Equity (x)	0.1	0.0	0.0	0.0	0.0
EV/EBITDA (x)	21.1	16.0	9.7	8.4	6.6
Price/Book (x)	10.6	8.3	5.8	4.4	3.4

Source: IIFL Research, Priced as on 05 February 2010

Expect 12-14% industry growth for the next few years:

Management expects the two-wheeler industry and Hero Honda to both grow at >20% in FY10, but said industry growth would stabilise at 12-14% in the years ahead.

GST introduction to lead to a 3-4% reduction in vehicle prices; could lead to removal of excise duty benefit from Uttaranchal plant:

Management said the current dual taxation structure (excise + sales tax) leads to a tax rate of 20-21%; if GST is introduced, it could bring this down to 17%. However, the draft GST code has no provision for tax-free zones, which means excise duty benefit from Uttaranchal could be removed once GST is introduced.

Compliance with new emission standards will lead to net burden of Rs250-300/bike:

Management said it plans to launch about 12 new variants in the next two months to make its entire portfolio compatible with BS III emission norms. After passing on most of the increase in cost, the net burden for the company would work out to Rs250-300/bike.

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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