

## Results Update

# Hero Honda Motors

**Accumulate | TP Rs.1722 (7%)**
**Sector Relative View/Sector Weightage: Outperform/Underweight**
**Mayur Milak (+91 22 6639 9149, mayur.milak@alchemyonline.com)**

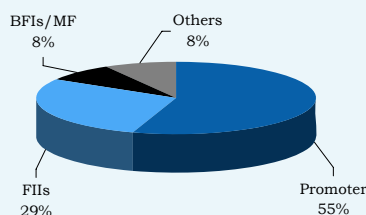
### Key points

- Hero Honda reported an EBIDTA margin of 18.3% in 2QFY10, 470bps higher yoy.
- We have upgraded our earnings estimate for FY10 and FY11 accordingly.

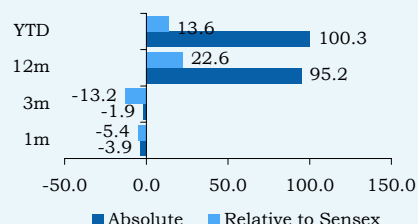
**CMP Rs1,613**

Reuters code	HROH.BO
Bloomberg code	HH IB
Shares o/s (mn)	200
Mkt Cap	Rs322bn/US\$6.9bn
52 wk high / Low	Rs1780/663
Avg daily trad vol	0.62(mn shs)
BSE Sensex	17,009
Nifty	5,064

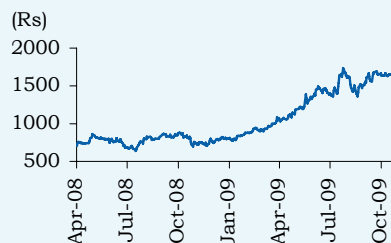
### Shareholding pattern



### Performance



### Share price movement



## Operational efficiency accelerates margins

### Outlook

Revenue	To grow ~20% yoy led by ~15% volume growth (to take total volumes beyond 4mn in FY10)
Margin	May not be sustainable due to increase in steel prices as well as tyre prices
Capex	Hero Honda has planned a capex of Rs3.5bn in FY10. To increase capacity to 5.4mn from 4.9mn
Valuation	Currently trading at a 15.0x FY11E EPS of Rs107.6.

### 2QFY10 result highlights

- Revenue:** Hero Honda's revenues grew in line with our expectation by 26.8% yoy to Rs40.5bn in 2QFY10 on the back of a volume growth of 21.7% yoy in 2QFY10. This was mainly because of a better sales mix and better realization.
- RMC:** The company posted a sharp decline (almost 430bps) in its raw material cost as a % to net sales at 68.1%. This was on account of lower steel costs as well as a better top-line realization. However, the company had reported 67.7% in 1QFY10.
- Staff cost and Other Expenses:** The staff cost as a % to net sales also came down sequentially by 20bps in 2QFY10. The other expenses was down sequentially by 140bps in 2QFY10.
- EBIDTA:** The EBIDTA margin grew by 470bps yoy to 18.3%. Hero Honda had reported 17.0% margin in 1QFY10.
- Tax:** A substantial tax benefit accrued to Hero Honda on account of company's full utilization of Haridwar plant.
- PAT:** The net profit grew 95% yoy to Rs5971mn, translating into an EPS of Rs29.9.
- New Launches:** The company has recently launched the new Karizma, Special edition of the Splendour+ for the festive season. It plans to launch 7 models this year across all segments.

### Valuation & view

We have upgraded our earnings estimates for FY10 and FY11 after the company reported strong EBIDTA margins for this quarter as well. Although we believe the margins would not be sustainable at these levels due to the increase in the steel prices and tyre costs as well.

Accordingly, we have revised our EPS for FY10E from Rs94.9 to Rs101.1. For FY11E our EPS stands revised from Rs99.9 to Rs107.6.

At CMP, the stock is trading at 15.9x FY10E and 15.0x FY11E (revised) earnings estimates. We maintain **Accumulate**.

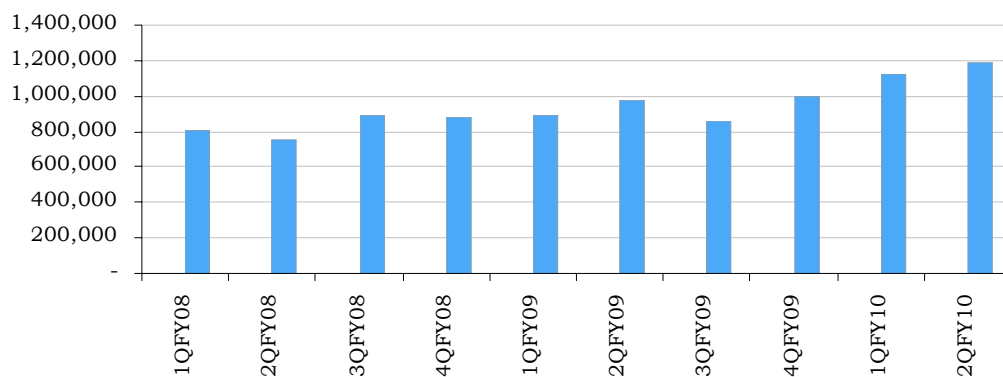
### Financial summary

Year end march (Rs.mn)	FY07	FY08	FY09	FY10E	FY11E
Net sales	99,000	103,318	123,569	147,788	167,592
Net profit	8,579	9,679	12,818	20,186	21,486
EPS (Rs)	43.0	48.5	64.2	101.1	107.6
ROCE (%)	31.8	30.8	34.6	41.3	32.8
ROE (%)	38.3	35.5	37.8	44.1	34.7
P/E (x)	15.9	14.2	16.7	15.9	15.0
EV/EBITDA (x)	11.8	10.2	12.1	12.4	12.0
P/BV	5.5	4.6	5.6	6.0	4.6

Source: Alchemy, Company, Bloomberg

**The company has consistently seen a growth in its motorcycle sales quarter on quarter during the last 4 quarters.**

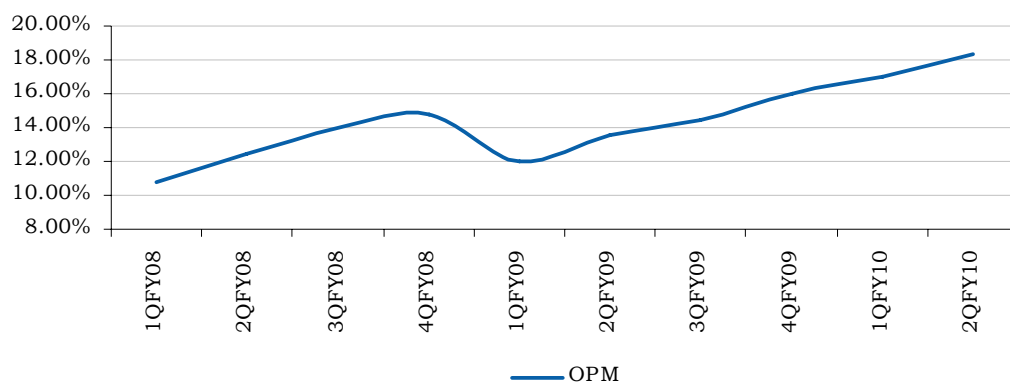
**Exhibit 1 - Quarterly Sales volume**



Source: Company, Alchemy Research

**Hero Honda has consistently seen a growth in its EBIDTA margins**

**Exhibit 2 - Operating margin**



Source: Company, Alchemy Research

**Exhibit 3 - Quarterly Results**

Rs mn	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10
Sales (in units)	<b>972,095</b>	<b>857,806</b>	<b>997,855</b>	<b>1,118,987</b>	<b>1,183,235</b>
YoY (%)	28.5	(4.0)	12.9	25.1	21.7
QoQ (%)	8.7	(11.8)	16.3	12.1	5.7
Net Sales	32,020.5	28,812.7	34,225.2	38,224.4	40,594.4
YoY (%)	36.1	5.0	22.7	34.4	26.8
QoQ (%)	12.6	(10.0)	18.8	11.7	6.2
(Inc) / Dec in Finished / Trading Goods	(832.1)	726.6	85.9	124.3	(49.7)
Consumption of raw materials	24,015.1	19,491.6	23,479.3	25,772.6	27,686.0
% of sales	72.4%	70.2%	68.9%	67.7%	68.1%
YoY (%)	36.3%	4.0%	19.5%	26.6%	19.2%
QoQ (%)	13.3%	-12.8%	16.6%	9.9%	6.7%
Staff cost	1,102.7	1,155.3	1,189.6	1,385.3	1,386.9
% of sales	3.4%	4.0%	3.5%	3.6%	3.4%
Other expenditure	3,385.9	3,269.2	3,979.6	4,441.0	4,129.5
% of sales	10.6%	11.3%	11.6%	11.6%	10.2%
<b>Total Expenditure</b>	<b>27,671.6</b>	<b>24,642.7</b>	<b>28,734.4</b>	<b>31,723.2</b>	<b>33,152.7</b>
<b>EBIDTA</b>	<b>4,348.9</b>	<b>4,170.0</b>	<b>5,490.8</b>	<b>6,501.2</b>	<b>7,441.7</b>
OPM (%)	13.6%	14.5%	16.0%	17.0%	18.3%
YoY (bps)	(150)	(90)	(210)	500	470
Other Income	538.8	435.9	442.4	424.8	687.1
Financial (income) / Expenses - Net	(83.4)	(87.4)	(96.3)	(54.6)	(61.0)
Depreciation	466.4	474.4	443.5	455.8	503.4
<b>PBT</b>	<b>4,504.7</b>	<b>4,218.9</b>	<b>5,586.0</b>	<b>6,524.8</b>	<b>7,686.4</b>
Taxation – Current, Deffered and FBT	1,441.7	1,214.4	1,564.3	1,523.7	1,715.0
Tax / PBT (%)	32.0%	28.8%	28.0%	23.4%	22.3%
<b>Net Profit</b>	<b>3,063.0</b>	<b>3,004.5</b>	<b>4,021.7</b>	<b>5,001.1</b>	<b>5,971.4</b>
NPM (%)	9.4%	10.3%	11.6%	12.9%	14.5%
YoY (%)	49.9	9.3	34.6	83.3	95.0
QoQ (%)	12.3	(1.9)	33.9	24.4	19.4
Paid-up Equity Share Capital (FV1/-)	199.67	199.67	199.67	199.67	199.67
EPS	15.34	15.05	20.14	25.05	29.91

Source: Company, Alchemy Research

Hero Honda's revenues grew in line with our expectation by 26.8% yoy to Rs40.5bn in 2QFY10 on the back of a volume growth of 21.7% yoy in 2QFY10.

The staff cost as a % to net sales also came down sequentially by 20bps in 2QFY10. The other expenses were down sequentially by 140bps in 2QFY10.

A substantial tax benefit accrued to Hero Honda on account of company's full utilization of Haridwar plant.

**Income Statement (Rs mn)**

Year	FY07	FY08	FY09E	FY10E	FY11E
<b>Net Sales</b>	<b>99,000</b>	<b>103,318</b>	<b>123,569</b>	<b>147,788</b>	<b>167,592</b>
Raw Materials	71,787	74,025	87,420	100,496	116,476
Employee Cost	3,538	3,835	4,487	5,173	6,033
Other Expenses	11,944	11,964	14,167	16,404	18,435
<b>Total Expenditure</b>	<b>87,269</b>	<b>89,824</b>	<b>106,074</b>	<b>122,073</b>	<b>140,945</b>
<b>EBITDA</b>	<b>11,730</b>	<b>13,494</b>	<b>17,495</b>	<b>25,715</b>	<b>26,647</b>
Other Income	2,145	2,232	2,151	2,480	2,680
Interest	16	20	25	30	30
Depreciation	1,398	1,603	1,807	1,950	2,100
<b>PBT</b>	<b>12,461</b>	<b>14,103</b>	<b>17,815</b>	<b>26,215</b>	<b>27,197</b>
Total tax	3,882	4,424	4,997	6,030	5,711
<b>Adjusted PAT</b>	<b>8579</b>	<b>9679</b>	<b>12818</b>	<b>20186</b>	<b>21486</b>

**Balance Sheet (Rs mn)**

Year	FY07	FY08	FY09E	FY10E	FY11E
Equity capital	399	399	399	399	399
Reserves & Surplus	24,301	29,463	37,608	53,122	69,935
<b>Net worth</b>	<b>24,701</b>	<b>29,862</b>	<b>38,008</b>	<b>53,521</b>	<b>70,335</b>
<b>Total debt</b>	<b>1,652</b>	<b>1,320</b>	<b>785</b>	<b>785</b>	<b>785</b>
<b>Total</b>	<b>26,352</b>	<b>31,182</b>	<b>38,793</b>	<b>54,306</b>	<b>71,119</b>
Net block	11,655	11,563	15,737	17,787	19,687
Capital WIP	1,899	3,924	1,205	1,205	1,205
<b>Total fixed assets</b>	<b>13,555</b>	<b>15,487</b>	<b>16,943</b>	<b>18,993</b>	<b>20,893</b>
Investments	19,739	25,668	33,688	45,688	60,688
<b>Net Working capital</b>	<b>-5,659</b>	<b>-8,880</b>	<b>-10,393</b>	<b>-8,930</b>	<b>-9,017</b>
<b>Current Assets</b>	<b>9,133</b>	<b>9,368</b>	<b>10,135</b>	<b>11,243</b>	<b>13,656</b>
Inventories	2,756	3,171	3,268	3,470	3,670
Debtors	3,353	2,974	1,499	2,259	3,469
Cash & bank	358	1,311	2,196	2,964	3,467
Other Current Assets	2,667	1,912	3,172	2,550	3,050
<b>Current Liabilities &amp; Provisions</b>	<b>14,792</b>	<b>18,247</b>	<b>20,528</b>	<b>20,173</b>	<b>22,673</b>
Creditors	5,548	7,561	7,030	10,000	12,000
Other liabilities	4,871	5,689	8,228	5,000	5,500
Provisions	4,372	4,998	5,270	5,173	5,173
Deferred Tax Liability	-1,282	-1,254	-1,444	-1,444	-1,444
Miscellaneous Exp	0	161	0	0	0

Source: Company, Alchemy Research

**Cash Flow (Rs mn)**

Year	FY07	FY08	FY09E	FY10E	FY11E
PAT	8,579	9,679	12,818	20,186	21,486
Add: Depreciation	1,398	1,603	1,807	1,950	2,100
Add: Interest expense	16	20	25	30	30
Less: Other income	(2,145)	(2,232)	(2,151)	(2,480)	(2,680)
Change in working capital	(2,986)	4,174	2,399	(695)	590
<b>Cash flow from operations</b>	<b>4,862</b>	<b>13,244</b>	<b>14,897</b>	<b>18,990</b>	<b>21,526</b>
Change in fixed assets	(5,017)	(3,536)	(3,262)	(4,000)	(4,000)
Change in investments	880	(5,930)	(8,020)	(12,000)	(15,000)
Other income	2,145	2,232	2,151	2,480	2,680
<b>Cash flow from investing activities</b>	<b>(1,992)</b>	<b>(7,233)</b>	<b>(9,131)</b>	<b>(13,520)</b>	<b>(16,320)</b>
Change in debt	(206)	(332)	(535)	0	0
Dividend & dividend tax	(4,554)	(3,972)	(4,439)	(4,672)	(4,672)
Interest paid	(16)	(20)	(25)	(30)	(30)
Other Adjustments	676	(734)	(199)	0	0
<b>Cash flow from financing activities</b>	<b>(4,100)</b>	<b>(5,058)</b>	<b>(5,198)</b>	<b>(4,702)</b>	<b>(4,702)</b>
Change in cash & cash equivalents	(1,229)	953	568	768	503
Opening cash and cash equivalents	1,587	358	1,311	2,196	2,964
<b>Closing cash and cash equivalents</b>	<b>358</b>	<b>1,311</b>	<b>1,878</b>	<b>2,963</b>	<b>3,467</b>

**Ratios**

Year	FY07	FY08	FY09E	FY10E	FY11 E
<b>% of net sales</b>					
Raw material costs	72.5	71.6	70.7	68.0	69.5
Employee costs	3.6	3.7	3.6	3.5	3.6
Other expenses	12.1	11.6	11.5	11.1	11.0
Total expenses	88.2	86.9	85.8	82.6	84.1
EBIDTA	11.8	13.1	14.2	17.4	15.9
PAT	8.5	9.2	10.2	13.4	12.6
<b>Asset based ratios</b>					
ROCE	31.8	30.8	34.6	41.3	32.8
ROE	38.3	35.5	37.8	44.1	34.7
<b>Turnover ratios (days)</b>					
Debtor days	9.1	11.2	6.6	4.6	6.2
Inventory days	9.3	10.5	9.5	8.3	7.8
Creditors days	30.5	32.3	30.5	30.9	34.5
Working capital days	(24.1)	(25.7)	(28.5)	(23.9)	(19.5)
Total asset turnover ratio	89.0	101.6	103.3	115.0	136.6
<b>Growth ratios (%)</b>					
Net Sales	13.6	4.4	19.6	19.6	13.4
EBITDA	(14.0)	15.0	29.7	47.0	3.6
EPS	(11.7)	12.8	32.4	57.5	6.4
CEPS	(8.1)	13.1	29.6	51.4	6.6
<b>Per share (Rs)</b>					
EPS	43.0	48.5	64.2	101.1	107.6
CEPS	50.0	56.5	73.2	110.9	118.1
BV	100.6	123.7	149.5	190.3	268.0
DPS	20.0	17.0	19.0	20.0	20.0
<b>Valuations (x)</b>					
P/E	15.9	14.2	16.7	15.9	15.0
P/CEPS	13.7	12.2	14.6	14.5	13.6
P/BV	5.5	4.6	5.6	6.0	4.6
Yield (%)	2.5	2.8	1.9	1.2	1.2
EV/EBITDA	11.8	10.2	12.1	12.4	12.0
EV/sales	1.4	1.3	1.7	2.2	1.9
<b>Solvency ratios</b>					
Current ratio	0.8	0.9	0.7	0.7	0.7
Quick ratio	0.0	0.1	0.1	0.2	0.2
D/E ratio	0.1	0.1	0.0	0.0	0.0

**The ratings are based on the absolute upside of our target price from the current price.**

Upside more than 25%	Strong Buy
Upside between 15-25%	Buy
Upside of up to 15%	Accumulate
Downside of up to 15%	Reduce
Downside of more than 15%	Sell

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Sector Relative call:	
Outperform	>5% upside to sector benchmark
Marketperform	+5% to -5% of sector benchmark
Underperform	>5% downside to sector benchmark

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Sector Weightage	
Overweight	
Equal weight	
Underweight	

### Sales

91-22-6639 9125

91-22-6639 9126

91-22-6639 9178

### Trade Execution

91-22-6639 9121

91-22-6639 9134

91-22-6639 9167

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