

STOCK DATA

Market Cap	Rs162 bn.
Book Value per share	Rs150
Eq Shares O/S (F.V. Rs. 2)	199.7 mn.
Median Volumes (12 mths)	230,320 (BSE+NSE)
52 Week High/Low	Rs865 / 561
Bloomberg Code	HH.IN
Reuters Code	HROH.BO

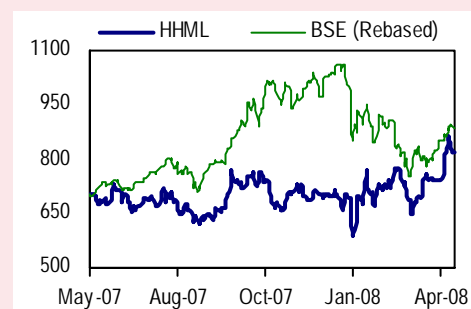
SHAREHOLDING PATTERN (%)

Qtr. Ended	Jun-07	Sep-07	Dec-07
Promoters	55.0	55.0	55.0
MFs/UTI/FIs	7.5	7.6	8.6
FII/NRI/OCBs	28.6	28.8	27.5
PCB	0.6	0.7	0.7
Indian Public	8.3	8.0	7.8

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	8.5	12.2	15.9
Relative	0.7	18.5	(8.0)

STOCK PRICE PERFORMANCE



KEY HIGHLIGHTS

Hero Honda Motors Ltd (HHML) reported a 5.6% rise in net sales to Rs27.9bn on back of a 3.3% YoY growth in volumes to 884k units & 2.3% improvement in realisations.

● **OPM higher than expectations at 14.8%, net profit up 53%**

Despite higher steel prices YoY, raw material cost slumped 240 bps YoY to 70.7% due to richer product mix & squeezing of vendors. While staff cost rose by 10 bps YoY, other expenditure was lower by 230 bps due to better volumes & lower marketing & sales promotion spends. This resulted in operating margins expanding by 460 bps YoY to 14.8%. Also, interest income & other income was higher by 6% & 24% YoY respectively which resulted in net profits surging 53% YoY to Rs2.8bn.

● **Market share gains**

In Q4FY08, HHML gained market share of 670 bps YoY & 700 bps QoQ to 58.7% in domestic motorcycles due to strong performance of *Splendor* & *Passion* alongwith incremental volumes of *Hunk* (launched in Oct-07) which has garnered almost 21% share of the premium segment.

● **Commissioned Uttaranchal plant in Apr'08**

After a delay of 6-7 months, HHML has finally commenced operations at its Uttaranchal plant in April'08. The plant has an initial capacity of 0.5 mn units and has entailed an investment of ~Rs4.2bn. The company plans to scale this up to 1.5 mn units over the next 2 years. The plant will provide fiscal incentives to the company for 10 years. HHML plans to shift production of its high volume motorcycles *Splendor* & *Passion* to this facility.

VALUATION AND RECOMMENDATION

At the CMP of Rs799, HHML is trading at a P/E of 11.5x & EV/EBIDTA of 5.4x its FY10E numbers. While it has improved its market share from 48.2% in FY07 to 54.5% FY08, we expect intense competition from new product launches especially in the executive segment.

While we have factored in tax savings from Uttaranchal plant, short term negatives, comparative valuations with peers & ageing motorcycles portfolio still proves to be a dampener on the overall outlook. On back of a strong performance, improving product mix and ability to maintain margins in sluggish market conditions, we upgrade our recommendation to 'HOLD' with a revised price target of Rs835.

KEY FINANCIALS (STANDALONE)

Rs mn	Quarter Ended			Yr Ended (March)				
	Sep-07	Dec-07	Mar-08	2006	2007	2008E	2009E	2010E
Net Sales	23,521	27,431	27,887	87,140	99,000	103,314	117,535	133,715
YoY Gr. (%)	5.5	2.9	5.6	17.3	14.4	3.8	12.1	13.1
Op. Profits	2,915	3,826	4,118	13,644	11,730	13,494	15,918	18,889
Op. Marg.(%)	12.4	13.9	14.8	15.7	11.8	13.1	13.5	14.1
Net Profits	2,043	2,750	2,987	9,713	8,579	9,679	11,556	13,904
Eq. Capital	399	399	399	399	399	399	399	399

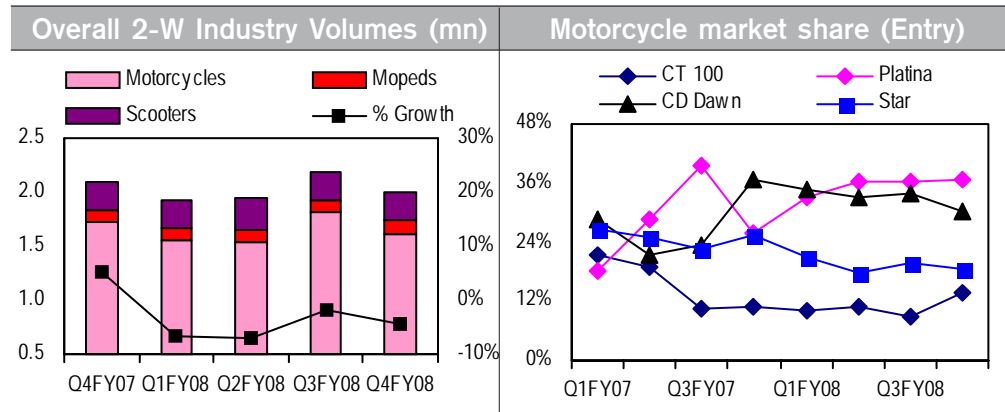
KEY RATIOS

	Yr Ended (March)				
	2006	2007	2008E	2009E	2010E
Dil. EPS (Rs)	48.6	43.0	48.5	57.9	69.6
ROCE (%)	69.9	50.5	48.0	45.1	43.0
RONW (%)	55.5	38.3	35.5	34.6	33.4
P/E (x)	16.4	18.6	16.5	13.8	11.5
EV/Sales (x)	1.4	1.2	1.1	0.9	0.8
EV/EBDIT (x)	9.2	10.4	8.5	6.9	5.4

INDUSTRY OVERVIEW

Domestic two-wheeler volumes fall by 5% YoY to 2.0 mn units...

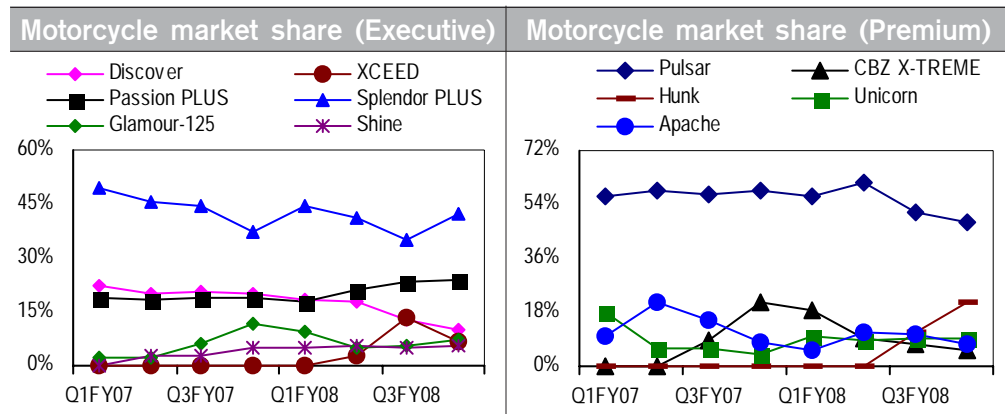
Rise in borrowing rates and tightening of financing norms by banks due to rising delinquencies led to a further 5% fall in overall 2-wheeler volumes to 2.0 mn units in Q4FY08. While domestic volumes were lower by 9% YoY at 1.8 mn units, exports surged 56% to ~215k units.



HHML has managed to regain a sizeable chunk of motorcycles market with a share of 58.7%...

Domestic motorcycle volumes slumped 11.3% YoY in Q4FY08 to 1.4 mn units. While share of HHML surged by 670 bps YoY to 58.7%, BAL & TVSM were the biggest losers with fall of 360 bps & 420 bps YoY to 25.2% & 8.0% respectively. This was due to strong growth in the executive segment where HHML improved its share coupled with marriage season especially in North India where it is a strong player.

While the economy & the premium segments slumped by ~34% & ~16% respectively, executive segment grew by 8% YoY in Q4FY08. BAL strengthened its position in the economy segment with its models *Platina* & *CT-100* garnering a market share of 50.4% of the entry level segment. On the other hand, HHML & TVSM were the biggest losers in this segment losing share of 670 bps each to 30.1% & 18.5%.



Source: Industry, CRIS Infac

In the executive segment, HHML maintained top slot improving market share by 480 bps YoY to 73%. This was led by robust performance of *Splendor* & *Passion*, although volumes of *Glamour* were considerably subdued. While *Xceed* volumes declined from ~120k units in Q3FY08 to 54k units in Q4FY08, TVSM's *Flame* clocked volumes of ~12k units.

In the premium segment, BAL lost 1000 bps market share to 49.4% due to sluggish volumes of *Pulsar*. The biggest beneficiaries in this segment were HHML & HMSI, which have improved market shares by 440 bps & 520 bps YoY to ~29.2% & 9.2% respectively. On the exports front, motorcycle volumes jumped 64% YoY to 206k units.

Despite a 0.5% drop in domestic scooter volumes to 254k units, overall scooter volumes were lower by 0.3%, due to a 6.3% rise in exports to 6k units. While HMSI maintained the top slot in scooters with a share of 62%, TVSM witnessed a recovery in volumes and market share in the segment.

PERFORMANCE OVERVIEW

While the performance of the company was in line with expectations on volumes front, it was significantly above expectations on margins & profitability fronts..

HHML outperformed the industry improving market share by 670 bps...

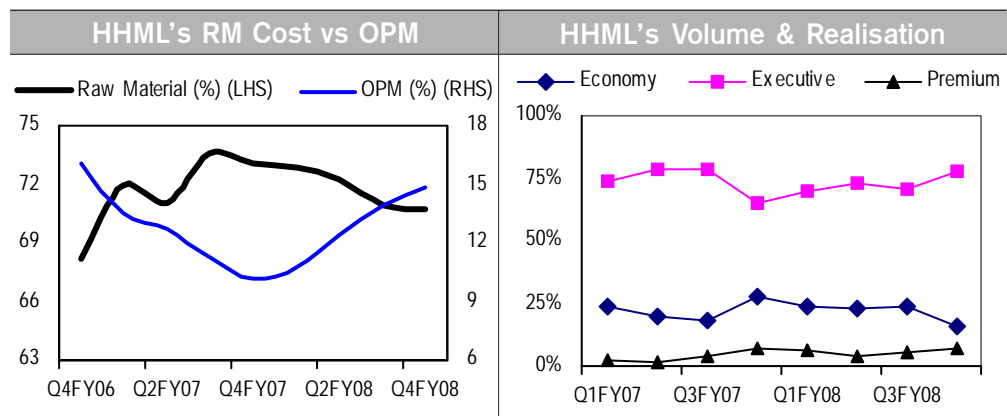
While industry's domestic motorcycle volumes fell by 11.3% to 1.41 mn units, HHML outperformed with a 0.2% rise in volumes to 830k units. This helped improve market share by 670 bps YoY to 58.7%. HHML's market share in the economy segment fell by 670 bps YoY to ~30% due to sluggish volumes of *CD Dawn*. In the executive segment, HHML further strengthened its position improving market share by 510 bps to ~73% due to strong volumes of *Splendor & Passion* even as *Glamour* volumes declined almost 36% YoY to ~58k units.

However, the key highlight during the quarter was the strong penetration of HHML's *Hunk* in the premium segment which alongwith *CBZ-Xtreme* helped the company garner a share of ~29% of the most lucrative segment. This in turn improved the product-mix in favour of executive & premium segment. Also, HHML's motorcycle exports jumped 69.8% YoY to 31k units.

HHML's domestic scooter volumes were higher by 17% YoY which resulted in 130 bps YoY improvement in market share to 9.1%. However, on a QoQ basis, market share has declined by 260 bps from 11.7% in Q3FY08.

Net Profits surged 32% YoY to Rs2.75bn...

The product-mix of the company improved in favour of executive & premium segment which helped realisations go up by 2.3% YoY to Rs31.5k/unit in Q4FY08. Net sales rose by 5.6% to Rs27.9bn.



Source: Pinc Research

OPM vaulted by 460 bps YoY to 14.8% due to fall in material cost & other expenditure. RM cost slumped by 240 bps to 70.7% of sales backed by better product-mix in favour of executive & premium segment & squeezing of vendors. Staff cost rose 10 bps to 3.5% & other expenditure fell 230 bps on higher volumes & lower advertising & marketing spend strategy adopted by the company in view of a slowdown in 2-wheeler industry volumes.

While, interest income rose 5.6% to Rs81mn & other income was higher by 23.9% to Rs551mn on back of treasury gains. Depreciation scaled up 22% YoY at Rs435mn. Consequently, net profits surged by 53.2% YoY to Rs2.99bn.

Capex Plans

After a delay of 6-7 months, HHML has finally commissioned Uttaranchal facility...

In light of a slowdown in domestic 2-wheeler industry, HHML has been delaying commissioning of its Uttaranchal facility for almost 7 months. The company has finally commenced operations at this plant in Apr'08 with an initial capacity of 0.5 mn units. The initial investment in the greenfield facility has been to the tune of ~Rs4.2bn. The company plans to ramp up capacity at this plant to 1.5 mn units over the next 2 years. HHML intends to shift production of its high volume motorcycles *Splendor & Passion* at this location. This has taken the current capacity of the company to 4.4 mn units which will stand at 5.4 mn units after full expansion at Uttaranchal. The plant will provide excise duty & sales tax exemption for 10 years. Also, 100% of income tax for the first 5 years & 30% for the next 5 years will be exempt.

INVESTMENT INCENTIVES

In the near term, we expect volumes to continue to be sluggish with possibilities of marginal growth, until interest rates begin to soften. However, we expect strong growth in motorcycles in the longer term (3-5 years) on back of low penetration, expected rise in personal disposable income, shortening replacement cycles and higher frequency of new platform introductions by players.

While *Splendor & Passion* platforms have been HHML's mainstay in the executive segment, *Glamour FI* (variant launched in Q1FY08) has helped offer more choice to customers. However, intensifying competition from BAL's *Xceed* & TVSM's *Flame* would put pressure on HHML's market share going forward. We believe, the company would have to introduce a new platform in the segment to retain market share.

In the premium segment, the company's offerings comprise of *CBZ Xtreme*, *Achiever*, *Karizma* & the recently introduced *Hunk*. Post introduction, *Hunk* has taken the 2nd slot taking away share from BAL's *Pulsar* which has lost share from ~58% in Q4FY07 to ~48% in Q4FY08 & TVSM's *Apache* (~10% vs 15%). While this segment continues to be the mainstay of BAL, HHML is trying to penetrate this segment with its slew of offerings and has garnered share of almost 29% of this segment. However, we believe, BAL's strategy of offering higher displacement motorcycles & high possibility of cannibalisation in HHML's own products will help BAL maintain its market share in the longer term.

We expect domestic motorcycles to grow at 10-12%, with HHML underperforming the industry...

INVESTMENT RISKS

Rise in interest rates to the tune of 400-500 bps over the past 2-3 quarters and tightening of financing norms by banks contributed to the fall in domestic motorcycle sales. With increase in the number of delinquencies, banks have further tightened their financing. This could prove to be a dampener on the overall industry volumes, until interest rates begin to soften. We expect interest rates to move southward in the next 2-3 quarters & expect better volume growth from Q3/Q4FY09 onwards.

Potential loss of market share in the executive segment due to intensifying competition from BAL's *XCD* & TVSM's *Flame* competing with an ageing product portfolio of HHML with no new launches in the segment. This coupled with continued slowdown in the domestic industry could lead to further margin pressure in the near term due to priority of market share over margins.

OUTLOOK

We expect growth of 8-9% CAGR in HHML's overall volumes over FY08-10. We also expect realisations to improve by 2-3% on back of a richer product-mix resulting in net sales rising to Rs133.7bn in FY10. We expect margins to be in the range of 13-14% due to higher input costs which would be offset by improving product-mix & tax savings from Uttaranchal. We expect other income to rise by 13-15% to Rs2.5bn & interest income to increase to Rs525mn in FY10. Thus, we expect earnings to edge up by 18-20% CAGR to Rs13.9bn translating into an EPS of Rs69.6 for FY10.

VALUATION

At the CMP of Rs799, HHML is trading at a P/E of 11.5x & EV/EBIDTA of 5.4x its FY10E numbers. Although it has improved market share from 48.2% in FY07 to 54.5% FY08, we expect intense competition from new product launches especially in the executive segment.

While we have factored in tax savings from Uttaranchal plant, short term negatives, comparative valuations with peers & ageing motorcycles portfolio still proves to be a dampener on the overall outlook. On back of an improved performance, improving product mix and ability to maintain margins in sluggish market conditions, we upgrade our recommendation to 'HOLD' with a revised price target of Rs835 (vs Rs744 earlier).

We upgrade our recommendation to 'HOLD' with a revised price target of Rs835...

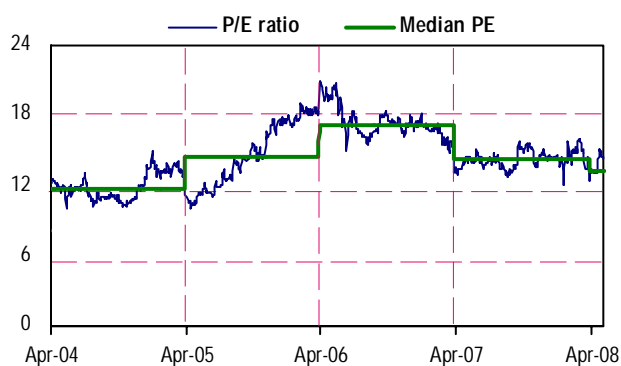
Company description

Hero Honda is the largest manufacturer of motorcycles in India. It is a JV between Hero Group (India) & Honda Motors (Japan). It has 2 plants located at Dharuhera & Gurgaon having a capacity of 3.9mn units with the 3rd plant expected to be commissioned in Uttaranchal in FY09. Hero Honda revolutionised motorcycles and brought about the transition from scooters to motorcycles in India more than a decade ago and has maintained its leadership position ever since.

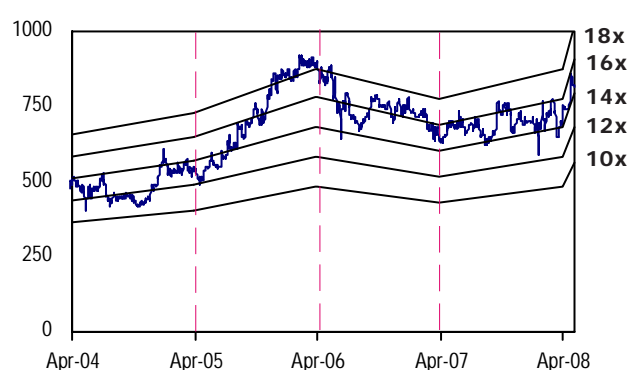
Financial Results for the quarter & year ended 31 March 2008 (Standalone)

Particulars (Rs Mn)	Quarter Ended			Year Ended		
	31/03/08	31/03/07	Gr %	31/03/08	31/03/07	Gr %
Net Sales	27,887	26,396	5.6	103,318	99,000	4.4
Expenditure	23,768	23,709	0.2	89,824	87,269	2.9
(Inc.) / Dec. in stock	(81)	113		(107.0)	22	
Materials	19,797	19,177	3.2	74,132.4	71,765	3.3
Staff Cost	988	905	9.2	3,834.5	3,538	8.4
Other expenditure	3,064	3,514	(12.8)	11,964.4	11,944	0.2
Operating profit	4,118	2,687	53.3	13,494	11,730	15.0
Other Income	551	445	23.9	1,854	1,899	(2.3)
PBIDT	4,670	3,132	49.1	15,348	13,629	12.6
Interest	81	77	5.6	358	230	55.8
Depreciation	(435)	(355)	22.4	(1,603)	(1,398)	14.7
PBT	4,316	2,854	51.3	14,103	12,461	13.2
Provision for tax	(1,316)	(854)		(4,368)	(3,758)	
Provision for deferred tax	(1)	(44)		(12)	(94)	
Provision for FBT	(12)	(6)		(44)	(30)	
Net Profit	2,987	1,950	53.2	9,679	8,579	12.4
Equity Capital (FV Rs 2)	399	399		399	399	
Reserves (excl. rev. res.)	-	-		29,463	24,301	
EPS for the period (Rs)	15.0	9.8		48.5	43.1	
Book Value (Rs)	-	-		150	124	
OPM (%)	14.8	10.2	4.6	13.1	11.8	1.3
NPM (%)	10.7	7.4	3.4	9.4	8.7	0.7
Expenditure (% of net sales)						
Raw Material	70.7	73.1		71.6	72.5	
Staff Costs	3.5	3.4		3.7	3.6	
Other Exp	11.0	13.3		11.6	12.1	
Volumes (Nos.)	884,075	855,984	3.3	3,337,142	3,336,756	0.0

Median PE v/s Daily PE



PE Band



Income Statement	2005	2006	2007	2008E	2009E	2010E
Revenues	74,217	87,140	99,000	103,314	117,535	133,715
<i>Growth %</i>	27.4	17.3	14.4	3.8	12.1	13.1
Total Expenditure	62,571	73,496	87,269	89,820	101,617	114,826
Operating Profit	11,645	13,644	11,730	13,494	15,918	18,889
Other Income	1,410	1,563	1,899	1,855	2,149	2,492
EBDIT	13,055	15,207	13,629	15,349	18,067	21,381
(-) Depreciation	894	1,146	1,398	1,604	2,089	2,436
(-) Interest	(11)	(61)	(230)	(358)	(425)	(525)
PBT & Minority Interest	12,173	14,122	12,461	14,103	16,403	19,470
(-) Tax Provision	4,068	4,409	3,882	4,424	4,847	5,567
(+) Prior Period Adj.	-	-	-	-	-	-
Net Profits	8,105	9,713	8,579	9,679	11,556	13,904
Fully Diluted Eq. Sh. O/S (mn nos.)	200	200	200	200	200	200
Book Value (Rs)	75	101	124	150	185	232
Basic E.P.S. (Rs)	40.6	48.6	43.0	48.5	57.9	69.6
Fully Diluted E.P.S. (Rs)	40.6	48.6	43.0	48.5	57.9	69.6

Balance Sheet	2005	2006	2007	2008E	2009E	2010E
<i>Equity Share Capital</i>	399	399	399	399	399	399
<i>Reserves & Surplus</i>	14,534	19,694	24,301	29,463	36,502	45,888
Net Worth	14,934	20,094	24,700	29,862	36,901	46,288
Total Borrowings	2,018	1,858	1,652	1,852	2,052	2,252
Deferred Tax Liability (Net)	1,009	1,188	1,282	1,294	1,324	1,369
Capital Employed	17,960	23,140	27,634	33,008	40,277	49,908
Fixed Assets	6,745	9,494	11,655	12,037	14,158	14,073
Capital WIP	409	442	1,899	1,500	1,000	1,000
Net Current Assets	(9,459)	(7,415)	(5,659)	(9,240)	(9,524)	(9,173)
Investments	20,267	20,619	19,738	28,711	34,643	44,009
Total Assets	17,960	23,140	27,634	33,008	40,277	49,908

Cash Flow Statement	2005	2006	2007	2008E	2009E	2010E
PBT & Extraord. items	12,173	14,122	12,461	14,103	16,403	19,470
Depreciation	894	1,146	1,398	1,604	2,089	2,436
Interest & Div. Income	(1,410)	(1,306)	(1,599)	(1,855)	(2,149)	(2,492)
Interest Paid	(11)	-	16	(358)	(425)	(525)
Tax Paid	(3,952)	(4,240)	(3,802)	(4,412)	(4,817)	(5,522)
(Inc.)/Dec. in WC	1,789	(362)	(2,224)	6,174	(166)	149
Cash from Operations	9,482	9,361	6,251	15,255	10,935	13,516
Net Capital exp.	(2,104)	(3,937)	(5,152)	(1,586)	(3,710)	(2,350)
Net Investment	(4,616)	700	2,162	(8,973)	(5,932)	(9,366)
Interest & Div Recd.	1,410	2	218	1,855	2,149	2,492
Cash from Investing Act.	(5,310)	(3,235)	(2,772)	(8,704)	(7,492)	(9,224)
Issue of Equity shares	-	-	-	-	-	-
Share Premium	-	-	-	-	-	-
Change in Loans (incl. FCCBs)	271	(160)	(206)	200	200	200
Interest	11	(29)	(16)	358	425	525
Equity Div. paid (incl. tax)	(4,517)	(4,523)	(4,521)	(4,517)	(4,517)	(4,517)
Cash from Financing Act.	(4,236)	(4,712)	(4,743)	(3,959)	(3,892)	(3,792)
Inc/(Dec) in Cash	(64)	1,413	(1,265)	2,592	(450)	500

Key Ratios	2005	2006	2007	2008E	2009E	2010E
EBIDT (%)	17.6	17.5	13.8	14.9	15.4	16.0
ROACE (%)	77.5	69.9	50.5	48.0	45.1	43.0
ROANW (%)	61.6	55.5	38.3	35.5	34.6	33.4
Sales/Total Assets (x)	0.2	0.2	0.2	0.3	0.3	0.3
Debt:Equity (x)	0.1	0.1	0.1	0.1	0.1	0.0
Current Ratio (x)	0.4	0.5	0.6	0.5	0.5	0.6
Debtors (Days)	3.8	5.7	10.5	5.6	5.7	5.8
Inventory (Days)	11.8	11.1	11.4	11.0	12.0	12.0
Working Capital (Days)	(39.7)	(26.5)	(17.6)	(27.8)	(25.5)	(21.7)
EV/Sales (x)	1.6	1.4	1.2	1.1	0.9	0.8
EV/EBIDT (x)	10.8	9.2	10.4	8.5	6.9	5.4
P/E (x)	19.7	16.4	18.6	16.5	13.8	11.5
P/BV (x)	10.7	7.9	6.5	5.3	4.3	3.4

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