

Hero Honda Motors

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India
Cyclical Consumers/Automobiles

HH IN
New Information
21 January 2008

Survivor & Thriver

SO WHAT? THE BNP PARIBAS ANGLE

- We remain cautious on the stock's valuation given weak earnings potential.
- Proprietary checks with on-the-ground contacts in the two-wheeler (2W) industry reveal sales slowdown.

Net Profit 09 INR12.0b
..... (Unchanged)

Diff from Consensus 0.0%
Consensus (mean) INR12.0b
Consensus (momentum) ↓

Target Price INR815.00
..... (Unchanged)

Diff from Consensus . (8.6%)
Consensus (median) INR892.03
Consensus (momentum) ↓

Current Price INR836.80
Upside/(Downside) (2.6%)

HOLD
(Unchanged)

Recs in the Market

Positive 22
Neutral 8
Negative 5
Consensus (momentum) ↔

Sources: Thomson One Analytics; Bloomberg; BNP Paribas estimates

- In-line quarter, margins begin to improve from lower commodity price, better pricing.
- Maintain our cautious view on 2W industry volumes. Expect Hero Honda to fair better than industry.
- Reiterate HOLD; maintain TP of INR815 (12x our FY10 EPS); lack of positive catalysts will limit absolute returns.

Strong performer in a weak industry

In-line quarter, improving margins impressive
Hero Honda reported 3Q EPS at INR15.04, up 9% y-y, slightly below our estimate of INR15.48. What was impressive during the quarter was the 80bps sequential improvement in its operating margin compared to our expectation of 20bps decline. We believe that the margin improvement was largely from lower raw material prices compared to previous quarter, as the company started reaping in the benefit of declining steel and aluminium prices (together accounting for 20% of its revenue). The company also benefited by retaining a part of the 4% CENVAT cut implemented in November, by selectively cutting prices on its models.

Maintain our cautious outlook on the industry
The 2W industry volumes declined 15% during the last 3 months, in line with our channel checks findings that had revealed significant weakness in consumer sentiment post festive season. We expect the industry volumes to remain flat over the next 6-9 months, and forecast a recovery only in 2HFY10. We expect that the recovery will be driven by gradual return of liquidity into the 2W loan market, as recent cuts in repo rate and CRR begin to percolate down in the form of cheaper and easier auto loans.

Slowing earnings growth will limit near-term returns
The 9% y-y EPS growth in the current quarter reaffirms our thesis that the 44% EPS growth seen during 3QFY08-2QFY09, will be difficult to sustain. We see weak industry fundamentals to weigh down on the company's earnings. We forecast an EPS growth of 6% in the next 2 quarters. We maintain our HOLD rating on the stock and TP of INR815, based on 12x FY10 EPS.

Retain our long-term positive bias, buy on dips
We remain impressed by the strong company fundamentals, 160bps market share improvement in last 3 months and margin gains during the quarter. We believe Hero Honda's growing market share, better product quality and significant rural exposure ensures that the company is in a position to emerge stronger from the current crisis. Significant dips in the stock can be viewed as entry points for a longer time-horizon.

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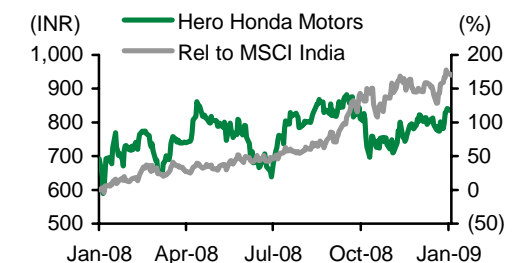
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Earnings Estimates And Valuation Ratios

YE Mar (INR m)	2008	2009E	2010E	2011E
Revenue	103,318	120,870	131,225	141,822
Reported net profit	9,679	11,983	13,607	15,906
Recurring net profit	9,679	11,983	13,607	15,906
Previous rec net profit	9,679	11,983	13,607	15,906
Chg from previous (%)	—	—	—	—
Recurring EPS (INR)	48.47	60.00	68.13	79.64
Prev rec EPS (INR)	48.47	60.00	68.13	79.64
Rec EPS growth (%)	12.8	23.8	13.6	16.9
Recurring P/E (x)	17.3	13.9	12.3	10.5
Dividend yield (%)	2.3	2.4	2.6	2.9
EV/EBITDA (x)	9.5	7.8	6.6	5.5
Price/book (x)	5.6	4.5	3.6	2.9
ROE (%)	35.5	35.6	32.4	30.6
Net debt/equity (%)	(85.9)	(80.2)	(80.4)	(84.2)

Sources: Hero Honda Motors; BNP Paribas estimates

Share Price Daily vs MSCI



Next results/event	February 2009
Market cap (USD m)	3,451
12m avg daily turnover (USD m)	7.7
Free float (%)	45
Major shareholder	Hero Group (29%)
12m high/low (INR)	888.40/592.80
ADR (USD)	Nil
Avg daily turnover (USD m)	Nil
Discount/premium (%)	Nil
Disc/premium vs 52-wk avg (%)	Nil

Source: Datastream

BNP Paribas research is available on Thomson Reuters, Bloomberg, and on <http://equities.bnpparibas.com>. Please contact your salesperson for authorisation. Please see the important notice on the back page.

FINANCIAL STATEMENTS

Hero Honda Motors

Profit and Loss (INR m)					
Year Ending March	2007A	2008A	2009E	2010E	2011E
Revenue	99,000	103,318	120,870	131,225	141,822
Cost of sales ex depreciation	(71,787)	(74,025)	(87,127)	(93,540)	(100,435)
Gross profit ex depreciation	27,213	29,293	33,743	37,685	41,387
Other operating income	-	-	-	-	-
Operating costs	(15,482)	(15,799)	(18,108)	(19,744)	(21,400)
Operating EBITDA	11,731	13,494	15,635	17,941	19,987
Depreciation	(1,398)	(1,603)	(1,918)	(2,330)	(2,570)
Goodwill amortisation	-	-	-	-	-
Operating EBIT	10,333	11,891	13,717	15,612	17,417
Net financing costs	230	358	196	227	446
Associates	-	-	-	-	-
Recurring non operating income	1,899	1,854	2,281	2,278	2,707
Non recurring items	-	-	-	-	-
Profit before tax	12,461	14,103	16,194	18,116	20,570
Tax	(3,882)	(4,424)	(4,210)	(4,509)	(4,664)
Profit after tax	8,579	9,679	11,983	13,607	15,906
Minority interests	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Other items	-	-	-	-	-
Reported net profit	8,579	9,679	11,983	13,607	15,906
Non recurring items & goodwill (net)	-	-	-	-	-
Recurring net profit	8,579	9,679	11,983	13,607	15,906
Per share (INR)					
Recurring EPS *	42.96	48.47	60.00	68.13	79.64
Reported EPS	42.96	48.47	60.00	68.13	79.64
DPS	17.00	19.00	20.00	22.00	24.00
Growth					
Revenue (%)	13.6	4.4	17.0	8.6	8.1
Operating EBITDA (%)	(14.0)	15.0	15.9	14.8	11.4
Operating EBIT (%)	(17.3)	15.1	15.4	13.8	11.6
Recurring EPS (%)	(11.7)	12.8	23.8	13.6	16.9
Reported EPS (%)	(11.7)	12.8	23.8	13.6	16.9
Operating performance					
Gross margin inc depreciation (%)	26.1	26.8	26.3	26.9	27.4
Operating EBITDA margin (%)	11.8	13.1	12.9	13.7	14.1
Operating EBIT margin (%)	10.4	11.5	11.3	11.9	12.3
Net margin (%)	8.7	9.4	9.9	10.4	11.2
Effective tax rate (%)	31.2	31.4	26.0	24.9	22.7
Dividend payout on recurring profit (%)	39.6	39.2	33.3	32.3	30.1
Interest cover (x)	na	na	na	na	na
Inventory days	12.8	14.6	13.0	12.3	12.3
Debtor days	9.1	11.2	9.7	10.0	10.0
Creditor days	53.8	58.4	54.9	51.2	50.2
Operating ROIC (%)	168.0	127.2	145.4	123.1	130.1
ROIC (%)	198.8	145.2	167.6	141.0	150.3
ROE (%)	38.3	35.5	35.6	32.4	30.6
ROA (%)	20.7	20.3	21.8	21.4	21.0

* Pre exceptional, pre-goodwill and fully diluted

Key Assumptions (INR m)	2007A	2008A	2009E	2010E	2011E
Volume (units)	3,336,756	3,337,142	3,702,449	3,938,047	4,151,423
Average realization (INR per vehicle)	29,670	30,960	32,646	33,322	34,162

Revenue By Division (INR m)	2007A	2008A	2009E	2010E	2011E
Domestic	96,103	100,514	117,571	127,229	136,958
Exports	2,897	2,804	3,299	3,995	4,864

Sources: Hero Honda Motors; BNP Paribas estimates

We expect EPS to grow only 8% in 2HFY09 and 13.6% in FY10 vs 47% in 1HFY09

We expect 80bp EBITDA margin expansion in FY10, driven by moderation in commodity prices, and higher fiscal benefits at new plant

We build in volume growth at 6.4% for FY10 with most of the growth in 2HFY10

Cash Flow (INR m)					
Year Ending March	2007A	2008A	2009E	2010E	2011E
Recurring net profit	8,579	9,679	11,983	13,607	15,906
Depreciation	1,398	1,603	1,918	2,330	2,570
Associates & minorities	(284)	4	-	-	-
Other non-cash items	25	51	161	(0)	(0)
Recurring cash flow	9,718	11,337	14,062	15,937	18,476
Change in working capital	(2,072)	2,612	(1,289)	(54)	1,511
Capex - maintenance	-	-	-	-	-
Capex - new investment	(5,190)	(3,749)	(4,000)	(4,000)	(4,000)
Free cash flow to equity	2,456	10,200	8,773	11,883	15,987
Net acquisitions & disposals	-	-	-	-	-
Dividends paid	(4,712)	(3,972)	(4,325)	(4,554)	(5,009)
Non recurring cash flows	342	995	-	-	-
Net cash flow	(1,914)	7,223	4,448	7,329	10,978
Equity finance	-	-	-	-	-
Debt finance	(206)	(332)	-	-	-
Movement in cash	(2,121)	6,892	4,448	7,329	10,978

Strong and consistent cash flow generation from operations

Per share (INR)					
Recurring cash flow per share	48.66	56.77	70.41	79.80	92.51
FCF to equity per share	12.30	51.08	43.93	59.50	80.05

Balance Sheet (INR m)					
Year Ending March	2007A	2008A	2009E	2010E	2011E
Working capital assets	8,775	8,057	8,830	9,471	10,255
Working capital liabilities	(14,792)	(18,247)	(17,731)	(18,318)	(20,613)
Net working capital	(6,017)	(10,191)	(8,902)	(8,847)	(10,358)
Tangible fixed assets	13,555	15,487	17,569	19,239	20,668
Operating invested capital	7,538	5,297	8,667	10,391	10,310
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Investments	-	-	-	-	-
Other assets	-	161	-	-	-
Invested capital	7,538	5,457	8,667	10,391	10,310
Cash & equivalents	(20,097)	(26,979)	(31,427)	(38,756)	(49,734)
Short term debt	-	-	-	-	-
Long term debt *	1,652	1,320	1,320	1,320	1,320
Net debt	(18,445)	(25,659)	(30,107)	(37,436)	(48,414)
Deferred tax	1,282	1,254	1,254	1,254	1,254
Other liabilities	-	-	-	-	-
Total equity	24,701	29,862	37,520	46,574	57,471
Minority interests	-	-	-	-	-
Invested capital	7,538	5,457	8,667	10,391	10,310

* Includes convertibles and preferred stock which is being treated as debt

Per share (INR)					
Book value per share	123.69	149.54	187.87	233.20	287.76
Tangible book value per share	123.69	149.54	187.87	233.20	287.76

Strong balance sheet with zero net debt

Financial strength					
Net debt/equity (%)	(74.7)	(85.9)	(80.2)	(80.4)	(84.2)
Net debt/total assets (%)	(43.5)	(50.6)	(52.1)	(55.5)	(60.0)
Current ratio (x)	2.0	1.9	2.3	2.6	2.9
CF interest cover (x)	na	na	na	na	na

Valuation	2007A	2008A	2009E	2010E	2011E
Recurring P/E (x) *	19.5	17.3	13.9	12.3	10.5
Recurring P/E @ target price (x) *	19.0	16.8	13.6	12.0	10.2
Reported P/E (x)	19.5	17.3	13.9	12.3	10.5
Dividend yield (%)	2.0	2.3	2.4	2.6	2.9
P/CF (x)	17.2	14.7	11.9	10.5	9.0
P/FCF (x)	68.0	16.4	19.0	14.1	10.5
Price/book (x)	6.8	5.6	4.5	3.6	2.9
Price/tangible book (x)	6.8	5.6	4.5	3.6	2.9
EV/EBITDA (x) **	10.8	9.5	7.8	6.6	5.5
EV/EBITDA @ target price (x) **	10.5	9.2	7.5	6.4	5.3
EV/invested capital (x)	19.7	25.9	15.8	12.5	11.5

* Pre exceptional, pre-goodwill and fully diluted

** EBITDA includes associate income and recurring non-operating income

Sources: Hero Honda Motors; BNP Paribas estimates

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*In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

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