

Will HondaJet make Honda's shares fly?

The car company's numbers indicate good value for a growth stock in a growing industry

By Sunil Vidyarthi

I am going to come clean and tell you it is very tough to find investment ideas these days, particularly good new ones. But, there are some that may work out shorter term. I say short term because visibility into 2008 and beyond is horrible.

Using Peter Lynch's theory of investing in what you know well, I have come up with Honda Motor Co. (HMC-NYSE, \$35.31, 813-342-1111, www.world.honda.com), which is engaged in the development, production and manufacture of motor products worldwide.

When my son practically destroyed my beautiful, old Buick Riviera, by ignoring the red light that kept coming on (his idea was to wait until it went off), we made a pact that others in the family may drive an older car, but he will have to drive a new one and will take it to the dealer if the light comes on, or for that matter, if anything seems suspicious.

The midnight calls from his Waterloo dorm were just too much (not to worry, I won't get into trouble over this; engineering students hardly ever read investment papers).

After much searching, we ended up with a Honda. It turns out the car hasn't depreciated much. In fact, a year later, I can sell the critter for nearly what I paid. It is



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really up there with the best in terms of fuel efficiency, and while it is no Carrera or Boxter, it has the best pep among four-cylinder cars. Honda fits into several attractive themes for the period ahead.

First, there is Japan. I know the investment thesis on Japan changes every week, but there is no denying that the '90s and the bulk of Japanese bank problems are over. I also find it difficult to understand why Japan, being the largest supplier, should suffer while China keeps growing at a double-digit rate. I am not anticipating '80s-like growth in Japan, but when an economy produces great products like Honda cars and bikes, it is only a matter of time before its preeminence is re-established.

Second, is the car industry itself. You may get an impression that the car business is in the dumps, listening to news out of Detroit. Not so. World-car usage is on the rise, as only a very small fraction of the population owns cars even though many could afford to. Developing infrastructure in most parts of the world is a priority, which means better roads and more cars.

And, of course, it won't come as news to you that Japanese cars are winning in most places. In Ahmedabad or Beijing, Honda is not a low-priced car, but a luxury

item fetching better prices than what I paid in Oakville, Ont.

Third is diversification. Here are a smattering of Honda's activities. Its motorcycle business manufactures bikes, all-terrain vehicles and personal watercraft. Honda's motorcycle line consists of sports, business and commuter models.

Its automobile business offers passenger cars under Legend, Accord, Civic, City, and Acura brands; multiwagons, minivans, sport utility vehicles, and sports coupes under Elysion, Odyssey, Step Wagon, Edix, FR-V, Stream, Fit, Jazz, Airwave, Pilot, Ridgeline, Element, CR-V and Acura brands; and minivehicles under Life, That's, Vamos, Zest, and Acty brands.

The company also offers various financial services to its customers and dealers. Further, Honda manufactures a number of products, including power tillers, portable generators, general-purpose engines, grass cutters, outboard engines, water pumps, snow throwers, power carriers, power sprayers, lawn mowers, and lawn tractors.

Cutting edge

Finally, there is not much point in investing in a cutthroat industry, like engineered and transportation products, unless your selected company is on the cutting edge. What really caught my eye was how Honda leads in really farsighted businesses like

robotics and small jets. You may have seen the white, Star-Wars-like robots at auto shows (Honda's creation) and noticed this news item in recent papers:

"Honda Motor, the Japanese carmaker, has begun selling its small business jet in the U.S. in an effort to gain a foothold in the lucrative and fast-growing market.

The HondaJet, sold at a starting price of \$3.65 million, seats five to six passengers and will go into production in 2010. The company plans to make 70 jets a year.

The commercial release of the HondaJet marks the culmination of 20 years of research and development, as well as realising the ambition of Soichiro Honda, the carmaker's late founder."

So, this all looks good, but what about the numbers? Honda's shares are trading at 11 times next year's earnings. They produce a return on equity of 16 per cent but trade at over 3.5 times book. It is good value if you buy the argument that Honda is a growth stock in what most consider a deadbeat industry of cars.

There is just one caveat to my bullish thesis and that is, if there is a serious slowdown in the world economy led by the U.S., all bets are off. In the last two recessions, it took over three years before you recouped your investment in Honda Motors.

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