



HPCL

BSE SENSEX 17,729
S&P CNX 5,310

Rs340

Buy

Bloomberg HPCLIN
Equity Shares (m) 339.0
52-Week Range (Rs) 555/293
1,6,12 Rel. Perf. (%) -2/-28/-12
M.Cap. (Rs b) 115.8
M.Cap. (US\$ b) 2.6

YEAR	SALES	ADJ. PAT	ADJ. EPS	EPS	P/E	P/BV	ROE	ROCE	EY/	EY/
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/10A	1,092,084	13,014	38.4	198.8	8.9	1.0	11.7	8.7	0.2	9.1
03/11E	1,280,669	13,110	38.7	0.7	8.8	0.9	10.9	8.3	0.2	8.1
03/12E	1,134,603	12,987	38.3	-0.9	8.9	0.9	10.1	8.0	0.2	7.4
03/13E	1,094,258	13,531	39.9	4.2	8.6	0.8	9.9	8.7	0.2	6.9

- HPCL reported EBITDA of Rs6.3b for 3QFY11 (v/s our estimate of Rs7.1b), up 4.4x YoY and down 73% QoQ. Lower than estimated EBITDA was due to higher net under-recoveries at Rs5.4b (v/s our estimate of Rs3.4b), partly compensated by higher GRM at US\$5.1/bbl (v/s our estimate of US\$4.8/bbl). PAT was Rs2.1b (v/s our estimate of Rs2.5b), up 6.7x YoY and down 90% QoQ. HPCL's 9MFY11 PAT was Rs4.2b (v/s our estimate of Rs13b for FY11).
- **GRM at US\$5.1/bbl:** GRM for 3QFY11 was US\$5.1/bbl (v/s -US\$0.3/bbl in 3QFY10; US\$2.7/bbl in 2QFY11). The regional benchmark Reuters Singapore GRM was US\$5.5/bbl. Refinery throughput stood at 4.1mmt (in line with our estimate), up 10% YoY and 35% QoQ. The significant QoQ jump is due to shutdown in the Visakh refinery in 2QFY11.
- **Government sharing ad-hoc; clarity only towards end-FY11:** In 9MFY11, HPCL's gross under-recovery was Rs103b, of which upstream shared Rs34b and the government shared Rs46b, resulting in net under-recovery of Rs23b. We currently model upstream share at 1/3rd, government share at 57% and OMCs' share at 10%. As in previous years, subsidy sharing is likely to be finalized only towards the end of the year (in 4Q); quarterly sharing is no indication of the final sharing formula. In 9MFY11, the government has announced Rs210b compensation to OMCs (yet to be disbursed by the government) and we expect further compensation in 4QFY11.
- **Valuation and view:** The stock trades at 8.9x FY12E EPS of Rs38.3 and 0.9x FY12E BV. We expect the government to spell out the sustainable subsidy sharing formula (at different oil prices) over the next few months. This should translate into higher valuations for HPCL. **Buy.**

QUARTERLY PERFORMANCE

(RS MILLION)

Y/E MARCH	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	241,976	244,566	292,329	313,213	292,264	281,385	339,025	367,995	1,092,084	1,280,669
Change (%)	-30.3	-31.0	-0.5	24.5	20.8	15.1	16.0	17.5	-12.4	17.3
EBITDA	10,876	-4	1,421	13,139	-16,155	23,224	6,267	18,522	25,432	31,858
% of Net Sales	4.5	0.0	0.5	4.2	-5.5	8.3	1.8	5.0	2.3	2.5
Change (%)	-364.6	-100.0	-69.9	-75.8	-248.5	nm	341.0	41.0	-12.1	25.3
Depreciation	2,629	2,833	3,007	3,175	3,174	3,234	3,647	3,919	11,644	13,973
Interest	2,702	2,493	2,202	1,640	1,968	2,200	2,417	2,415	9,038	9,000
Oil (incl. Oper. other inc)	4,403	3,237	4,373	4,450	2,469	3,817	2,984	1,490	16,463	10,760
Exceptional Item	0	2	0	37	-14	-2			38	-16
PBT	9,948	-2,094	585	12,774	-18,843	21,608	3,188	13,678	21,213	19,631
Tax	3,457	-727	271	5,236	0	712	1,078	4,732	8,237	6,521
Rate (%)	34.8	34.7	46.3	41.0	0.0	3.3	33.8	34.6	38.8	33.2
PAT	6,491	-1,367	314	7,538	-18,843	20,896	2,110	8,947	12,977	13,110
Change (%)	nm	-95.8	nm	-85.2	nm	nm	571.2	18.7	126.0	1.0
Key Assumptions (Rsb)										
Gross under recovery	12	22	29	37	44	24	34	51	100	153
Upstream sharing	2	8	10	14	15	8	11	17	33	51
Oil Bonds/Cash subsidy	0	0	19	37	0	28	17	41	56	87
Net Under recovery	10	15	1	-13	29	-12	5	-7	12	15
Net Sharing (%)	85.1	65.7	2.8	nm	66.7	nm	15.7	nm	12.2	10

E: MOSL Estimates

Harshad Borawake (HarshadBorawake@MotilalOswal.com); +91 22 3982 5432

Bivek Anand (Bivek.Anand@MotilalOswal.com); +91 22 3982 5426 / Milind Bafna (Milind.Bafna@MotilalOswal.com); +91 22 3982 5445

Operational performance

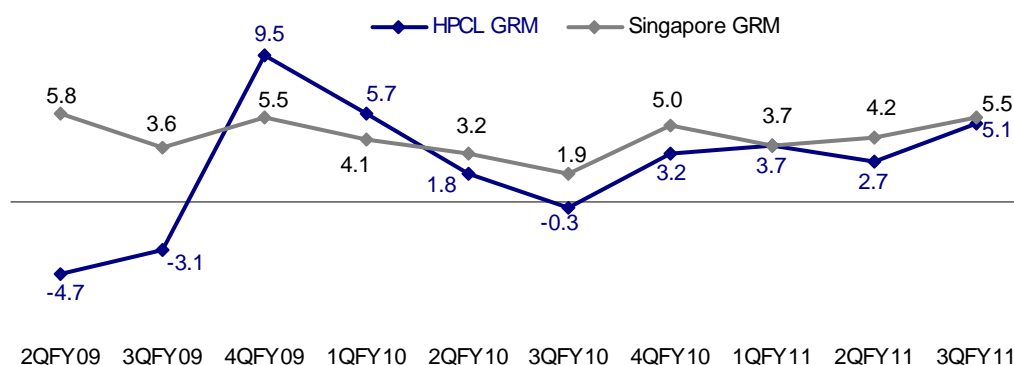
- GRM for 3QFY11 was US\$5.1/bbl (v/s -US\$0.3/bbl in 3QFY10; US\$2.7/bbl in 2QFY11). The regional benchmark Reuters Singapore GRM was US\$5.5/bbl.
- Refinery throughput stood at 4.1 mmt (in line with our estimate), up 10% YoY and 35% QoQ. The significant QoQ jump is due to shutdown in the Visakh refinery in 2QFY11.
- Marketing volumes were 7.1 mmt, up 6% YoY and 17% QoQ.

Operational Highlights

	FY10				FY11			3QFY11 (%)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	YoY	QoQ
Marketing Volumes (mmt)	6.8	6.3	6.7	6.5	6.7	6.0	7.1	6	17
Throughput (mmt)									
Mumbai	1.8	1.8	1.5	1.8	1.2	1.5	1.8	21	20
Visakh	2.3	2.2	2.2	2.1	2.1	1.5	2.3	3	50
Total	4.1	4.0	3.7	3.9	3.3	3.0	4.1	10	35
Blended GRM (US\$/bbl)	5.7	1.8	(0.3)	3.2	3.7	2.7	5.1	nm	93

Source: Company/MOSL

Reported GRM has been Trending Below Singapore GRM (US\$/bbl)



Source: Company/MOSL

Government sharing ad-hoc; clarity only towards end-FY11

- In 9MFY11, HPCL's gross under-recovery was Rs103b, of which upstream shared Rs34b and the government shared Rs46b, resulting in net under-recovery of Rs23b.
- We currently model upstream share at 1/3rd, government share at 57% and OMCs' share at 10%. As in previous years, subsidy sharing is likely to be finalized only towards the end of the year (in 4Q); quarterly sharing is no indication of the final sharing formula.
- In 9MFY11, the government has announced Rs210b compensation to OMCs (yet to be disbursed by the government) and we expect further compensation in 4QFY11.

HPCL's Subsidy Sharing: Net Sharing at 22% in 9MFY11; We Model 10% for FY11 (Rs b)

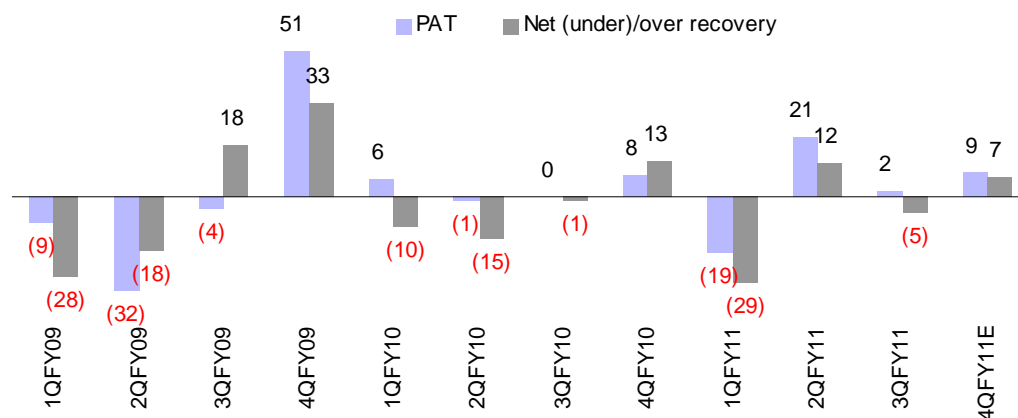
	FY10				FY11			3QFY11		FY10	9MFY11	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	YOY (%)	QOQ (%)			
Gross Under recovery	11.6	22.2	29.4	37.2	44.1	24.2	34.3	16	41	100.4	102.6	153.3
Less: Sharing												
Upstream Sharing	1.7	7.6	9.6	13.5	14.7	8.1	11.4	18	41	32.5	34.2	51.1
Oil Bonds/Cash	0.0	0.0	19.0	36.7	0.0	28.3	17.5	-8	-38	55.6	45.8	86.8
Net Under/(over) recovery	9.9	14.6	0.8	(13.0)	29.4	(12.2)	5.4	546	nm	12.3	22.6	15.4
As a % of Gross	85.1	65.7	2.8	nm	66.7	nm	nm			12.2	22.0	10.0

Source: Company/MOSL

Other highlights

- Gross debt increased significantly QoQ to Rs220b v/s Rs200b in 2QFY11, resulting in jump in interest cost to Rs2.4b v/s Rs2.2b in 2QFY11.
- Oil bonds on the balance sheet stood at Rs80.5b at the end of 3QFY11.
- Other income of Rs3b includes forex gain of Rs1.5b.

Ad-hoc Subsidy Sharing Resulting in Volatile Quarterly Profits (Rs b)



*Net Under-recovery = Gross Under-recovery less Government and Upstream Sharing

Source: Company/MOSL

We Model OMCs' Sharing at 10% in FY11 and FY12

	FY08	FY09	FY10	9MFY11	FY11E	FY12E
Fx Rate (Rs/US\$)	40.3	46.0	47.5	45.7	45.5	45.0
Brent (US\$/bbl)	82.3	84.8	69.6	80.2	82.7	80.0
Gross Under recoveries (Rs b)						
Petrol	73	52	52	27	27	-
Diesel	353	523	93	173	277	236
PDS Kerosene	191	282	174	135	185	181
Domestic LPG	156	176	143	135	205	207
Total	773	1,033	461	470	695	624
Sharing (Rs b)						
Oil Bonds/Cash	353	713	260	210	396	354
Upstream	257	329	145	155	230	208
OMC's sharing	163	(9)	56	105	69	62
Total	773	1,033	461	470	695	624
Sharing (%)						
Oil Bonds	46	69	56	45	57	57
Upstream	33	32	31	33	33	33
OMC's sharing	21	(1)	12	22	10	10
Total	100	100	100	100	100	100

Source: Company/MOSL

Valuation and view

The stock trades at 8.9x FY12E EPS of Rs38.3 and 0.9x FY12E BV. We expect the government to spell out the sustainable subsidy sharing formula (at different oil prices) over the next few months. This should translate into higher valuations for HPCL. **Buy.**

HPCL: an investment profile

Company description

A Fortune-500 company, HPCL is a refining and marketing company in India and also has interests in upstream. It owns 13.5mmt of refining capacity, split across Mumbai (5.5mmt) and Vishakapatnam (7.5mmt). It has a crude and product pipeline network of ~2,100km and sells ~26mmt of petroleum products. HPCL also holds a 16.9% stake in MRPL, a standalone refiner, which it jointly promoted. MRPL is now a subsidiary of ONGC. HPCL is a state-owned company, with 51.11% Government of India (GoI) stake.

Key investment arguments

- HPCL's profitability continues to be determined by the quantum of under-recoveries and sharing mechanism, rather than fundamentals. Recently hopes were rejuvenated by the partial de-regulation in July 2010, but no further policy decision has been taken by GoI.
- Medium to long-term growth would come from its 9mmtpa grassroots refinery being setup in JV (~50% stake) with Mittal Energy Investments, with an estimated capex of Rs172b.
- HPCL's valuations should benefit due to improvements in (1) earnings quality, (2) RoCE and RoE, (3) cash cycle, and (4) debt levels.

Key investment risks

- Delays in the diesel deregulation and ad-hoc subsidy sharing
- Non-commensurate increase in retail fuel prices as oil prices rise leads to under-recoveries for the company, and ad-hoc nature of subsidy sharing impacts profits.

Recent developments

- Partial deregulation of auto fuels and price hikes of domestic fuels in June 2010

Valuation and view

- The stock trades at 8.9x FY12E EPS of Rs38.3 and 0.9x FY12E BV. **Buy.**

Sector view

- We expect refining margins to remain range-bound amid economic recovery and prevailing cold winters. However, the ceiling would be capped in the near term due to significant new capacities coming online in FY12/13. We expect demand-supply gap to correct only through the refinery closures of simple refiners and continuous pick-up in global demand.

Target Price and Recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
340	-	-	Buy

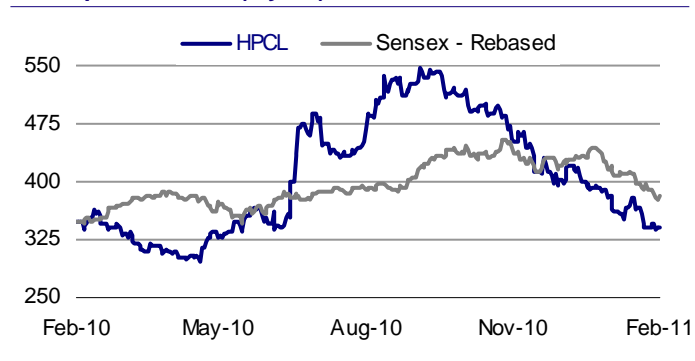
EPS: MOSL forecast v/s consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	38.7	41.1	-5.9
FY12	38.3	46.4	-17.4

Shareholding Pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	51.1	51.1	51.1
Domestic Inst	27.7	27.9	26.9
Foreign	8.6	9.0	11.6
Others	12.6	12.1	10.4

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT		(RS MILLION)			
Y/E MARCH	2010	2011E	2012E	2013E	
Net Sales	1,092,084	1,280,669	1,134,603	1,094,258	
<i>Change (%)</i>	-12.4	17.3	-11.4	-3.6	
Finished Gds Purchase	642,488	828,630	650,112	605,766	
Raw Materials Cons	344,776	368,844	415,542	415,467	
Employee Costs	16,173	16,833	17,002	18,362	
Other Exp	63,215	34,503	19,500	19,711	
EBITDA	25,432	31,858	32,449	34,953	
<i>% of Net Sales</i>	2.3	2.5	2.9	3.2	
<i>% Growth</i>	-12.1	25.3	1.9	7.7	
Depreciation	11,644	13,973	15,276	16,990	
Interest	9,038	9,000	8,190	9,620	
Other Income	16,462	10,761	10,465	11,918	
Extraordinary Items (net)	38	-16			
PBT	21,250	19,631	19,447	20,261	
Tax	8,237	6,521	6,460	6,730	
<i>Total Rate (%)</i>	38.8	33.2	33.2	33.2	
Extraordinary - Tax writeback					
PAT	13,014	13,110	12,987	13,531	
Adjusted PAT	13,014	13,110	12,987	13,531	
<i>Change (%)</i>	198.8	0.7	-0.9	4.2	

BALANCE SHEET		(RS MILLION)			
Y/E MARCH	2010	2011E	2012E	2013E	
Share Capital	3,390	3,390	3,390	3,390	
Reserves	112,190	120,540	129,165	137,936	
Net Worth	115,580	123,930	132,555	141,326	
Loans	213,024	200,000	190,000	180,000	
Deferred Tax	18,080	19,497	21,441	23,467	
Capital Employed	346,683	343,427	343,996	344,794	
Gross Fixed Assets	249,884	292,760	330,760	360,760	
Less: Depreciation	96,817	110,790	126,066	143,056	
Net Fixed Assets	153,067	181,970	204,693	217,703	
Capital WIP	38,876	16,000	8,000	8,000	
Investments	113,873	71,013	78,791	67,161	
Curr. Assets, L & Adv.	206,419	212,108	186,267	185,399	
Inventory	125,792	152,843	130,531	124,907	
Debtors	24,373	28,582	25,322	24,422	
Cash & Bank Balance	2,431	7,202	6,933	12,589	
Loans & Advances	52,585	22,244	22,244	22,244	
Other Current Assets	1,237	1,237	1,237	1,237	
Current Liab. & Prov.	165,552	137,664	133,755	133,469	
Liabilities	144,499	118,647	114,055	112,293	
Provisions	21,053	19,016	19,700	21,176	
Net Current Assets	40,867	74,444	52,512	51,930	
Application of Funds	346,683	343,427	343,996	344,794	

E: MOSL Estimates

RATIOS		(RS MILLION)			
Y/E MARCH	2010	2011E	2012E	2013E	
Basic (Rs)					
EPS	38.4	38.7	38.3	39.9	
Cash EPS	113.4	132.6	134.0	143.0	
Book Value	340.9	365.6	391.0	416.9	
DPS	12.0	12.0	11.0	12.0	
Payout (incl. Div. Tax.)	16.1	36.3	33.6	35.2	
Valuation (x)					
P/E	8.9	8.8	8.9	8.6	
Cash P/E	3.0	2.6	2.5	2.4	
EV / EBITDA	9.1	8.1	7.4	6.9	
EV / Sales	0.2	0.2	0.2	0.2	
Price / Book Value	1.0	0.9	0.9	0.8	
Dividend Yield (%)	3.5	3.5	3.2	3.5	
Profitability Ratios (%)					
RoE	11.7	10.9	10.1	9.9	
RoCE	8.7	8.3	8.0	8.7	
Turnover Ratios					
Debtors (No. of Days)	7.8	7.5	8.7	8.3	
Asset Turnover (x)	4.8	4.7	3.6	3.2	
Leverage Ratio					
Debt / Equity (x)	1.8	1.6	1.4	1.3	

CASH FLOW STATEMENT		(RS MILLION)			
Y/E MARCH	2010	2011E	2012E	2013E	
OP/(Loss) before Tax	21,250	19,631	19,447	20,261	
Depreciation	11,679	13,973	15,276	16,990	
Other op	-5,715	-117,140	-79,777	-43,370	
Interest Paid	16,075	9,000	8,190	9,620	
Direct Taxes Paid	-3,946	-5,104	-4,515	-4,704	
(Inc)/Dec in Wkg. Capital	-6,530	-28,807	21,663	6,239	
Oil Bonds					
CF from Op. Activity	32,814	-108,447	-19,716	5,036	
(Inc)/Dec in FA & C/WIP	-36,180	-20,000	-30,000	-30,000	
(Pur)/Sale of Investments	16,601	160,000	72,000	55,000	
Loans and Advances					
Inc from Invst	8,037	0	0	0	
CF from Inv. Activity	-11,542	140,000	42,000	25,000	
Inc / (Dec) in Debt	-9,781	-13,024	-10,000	-10,000	
Interest paid & other Inv	-11,224	-9,000	-8,190	-9,620	
Dividends Paid	-2,093	-4,759	-4,363	-4,759	
CF from Fin. Activity	-23,097	-26,783	-22,553	-24,379	
Inc / (Dec) in Cash	-1,825	4,770	-269	5,656	
Add: Op. Balance	6,083	2,431	7,202	6,933	
Bank Balance Adj.	-1,826	1	0	0	
Closing Balance	2,431	7,202	6,933	12,589	



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

	HPCL
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.