



Lackluster quarter

- HPCL reported a loss of Rs30.8bn for 1QFY12, higher than estimated, with its under-recoveries in the quarter at Rs30.6bn .
- GRM was at US\$1.1/bbl (4QFY11 \$8.5/bbl). GRM declined owing to revaluation of crude inventory following withdrawal of customs duty.
- Crude throughput declined 8% QoQ with declines at Mumbai and Vizag. Blended utilisation declined 9% QoQ. Market sales grew 0.7% QoQ as against industry growth of 3.1% QoQ.
- HPCL has an outstanding payment of US\$1bn to be made on crude purchased from Iran. The payment is likely to be made in 2QFY12. The company has Rs9bn outstanding dues from Indian Airlines.
- HPCL recorded inventory gain of Rs2.2bn on products during 1QFY12.
- The new refinery at Bhatinda is mechanically complete and is expected to commission in November 2011.
- Although HPCL benefits from the recent fall in crude price, uncertainty on the subsidy sharing formula will continue to weigh on the stock.

Financial summary (Rs m)

Y/e 31 Mar	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	FY11	FY12ii	FY13ii
Refinery Throughput (mmt)	4.0	3.7	3.9	3.3	3.0	4.1	4.3	4.0	14.8	17.1	17.5
% growth	-4.1	-8.6	-6.2	-19.8	-24.4	9.9	10.5	20.7	-6.4	15.9	2.2
Market Sales (mmt)	6.3	6.7	6.5	6.7	6.0	7.1	7.2	7.3	27.1	28.4	29.6
% growth	4.2	4.2	-4.7	-1.6	-3.7	5.9	10.9	8.0	3.2	4.8	4.2
GRM (\$/bbl)	1.8	-0.4	3.2	3.7	2.7	5.1	8.6	1.1	5.3	5.8	6.0
% growth	0.0	0.0	-66.2	-34.9	47.8	-1482.8	165.5	-70.7	97.4	8.6	4.8
Revenues (Rs m)	244,566	276,619	313,213	292,199	307,097	339,025	396,668	407,980	1,384,928	1,506,561	1,672,298
% change	-31.0	-5.9	24.5	20.8	25.6	22.6	26.6	39.6	24.2	8.8	11.0
EBITDA (Rs m)	-4	1,421	13,139	-16,155	23,224	6,267	19,751	-26,849	35,541	39,641	48,880
EBITDA Margins (%)	0.0	0.5	4.2	-5.5	7.6	1.8	5.0	-6.6	2.6	2.6	2.9
Interest expense (Rs m)	-2,493	-2,202	-1,640	-1,968	-2,200	-2,417	-2,255	-2,641	-9,105	-10,508	-12,128
Effective tax rate (%)	34.7	46.3	40.9	0.0	3.3	33.8	35.9	0.0	35.0	34.4	35.5
Reported PAT (Rs m)	-1,367	314	7,575	-18,843	20,900	2,110	11,227	-30,803	17,036	16,696	16,798
PAT (Pre-Exceptional) (Rs m)	-1,367	314	7,575	-18,843	20,900	2,110	11,227	-30,803	17,036	16,696	16,798
% change	-95.8	-107.4	-85.2	-390.3	-1629.0	572.1	48.2	63.5	15.7	-2.0	0.6

Source: Company, IIFL Research. Priced as on 12 August 2011

Result update

CMP	Rs384	Price performance (%)			
12-mth TP (Rs)	340 (-11%)		1M	3M	1Y
Market cap (US\$ m)	2,863	HPCL	-4.0	-1.0	-21.4
Bloomberg	HPCL IN	Rel. to Sensex	4.5	7.2	-14.6
Sector	Oil & Gas	BPCL	3.4	4.6	2.4
		Reliance Inds	-10.2	-19.5	-21.8
		Indian Oil Corp	-4.7	-7.2	-15.1
Shareholding pattern (%)		Stock performance			
Government of India	51.1	52Wk High/Low (Rs)	556/304		
FIIIs	9.3	Shares o/s (m)	339		
DIIIs	29.1	Daily volume (US\$ m)	9		
Public	10.5	Dividend yield FY12ii (%)	3.7		
		Free float (%)	49.0		

Figure 1: 1QFY12 losses higher than estimates

(Rsm)	1QFY11	4QFY11	1QFY12	%YoY	%QoQ
Net revenue	292,199	396,668	407,980	40%	3%
Total operating costs	308,354	376,917	434,829	41%	15%
Employee costs	3,662	7,860	5,395	47%	-31%
Purchase of products	197,416	241,210	271,150	37%	12%
Raw material consumption	97,951	109,845	147,057	50%	34%
Other expenses	9,325	18,002	11,227	20%	-38%
EBITDA	(16,155)	19,751	(26,849)	66%	-236%
EBITDA margin (%)	5.0%	5.0%	-6.6%	-1156bps	-1156bps
Other income	2,469	4,165	2,585	5%	-38%
PBITD	(13,687)	23,916	(24,264)	77%	-201%
Depreciation	3,174	4,015	3,886	22%	-3%
Interest	1,968	2,255	2,641	34%	17%
PBT	(18,829)	17,645	(30,791)	64%	-274%
Tax	0	6,282	0	NA	NA
Tax rate (%)	0%	36%	0%	bps	-3560bps
Adj PAT	(18,829)	11,363	(30,791)	64%	-371%
Adj PAT margin (%)	3%	3%	-8%	-1041bps	-1041bps
EO items	(14)	(137)	(12)		
Reported PAT	(18,843)	11,227	(30,803)	63%	-374%
PAT margin (%)	3%	3%	-8%	-1038bps	-1038bps
Shares outstanding (m)	338.63	338.63	338.63		
Reported EPS	(55.64)	33.15	(90.96)		

Source: Company, IIFL Research

Revenue factors in 33% subsidy contribution from the government at Rs30.6bn

EBITDA loss on subsidy burden sharing of 33% of overall under-recoveries, weaker overall GRMs

Interest costs up 64% YoY and 17% QoQ on increased borrowings; to remain on a higher trajectory due to lag in receipt of cash subsidy from government

Figure 2: Government contribution comes in at 33%, still HPCL had to bear Rs30.6bn of subsidy during the quarter

(Rsm)	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
Upstream discount	14,700	8,080	11,420	32,130	31,668
Govt aid	0	28,320	17,480	43,960	32,747
Borne by HPCL	29,390	-12,160	5,370	-7,510	30,605
Total	44,090	24,240	34,270	68,580	95,020

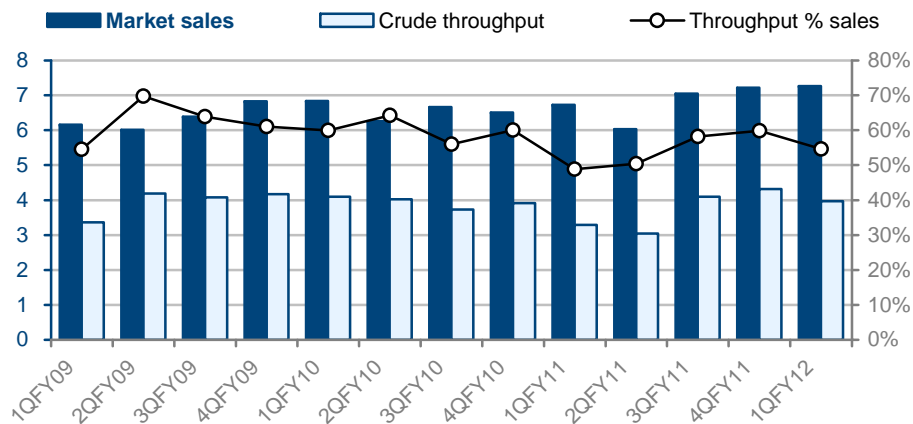
Source: Company, IIFL Research

Figure 3: HPCL's had high Diesel under-recovery on non-increase of prices during the quarter

(Rsm)	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
Diesel	21,910*	7,070	12,990	37,500	62,330
PDS Kerosene and LPG	22,180	17,170	21,280	31,080	32,690
Total	44,090	24,240	34,270	68,580	95,020

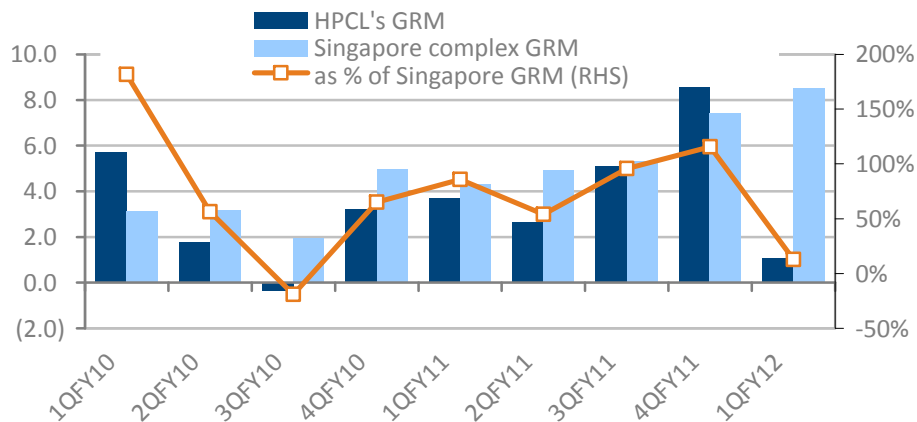
Source: Company, IIFL Research. *Under recovery on MS up to 25th June 2010

Figure 4: Crude throughput was down on QoQ basis, maintained product sales through higher product purchases



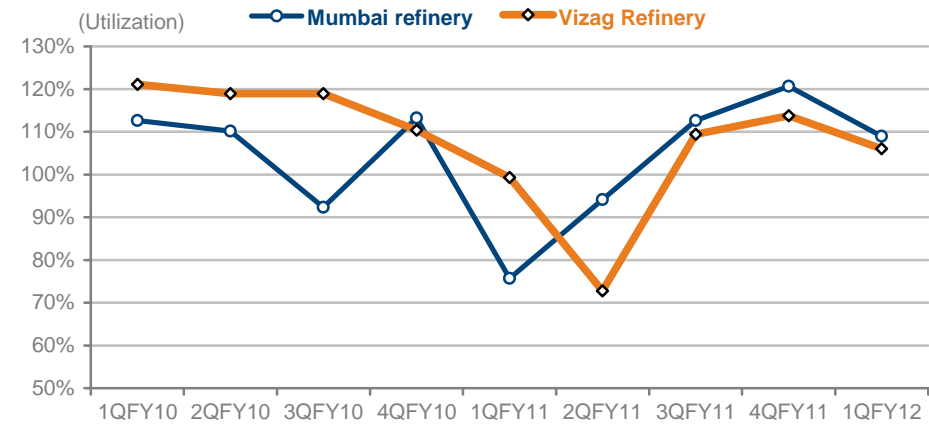
Source: Company, IIFL Research

Figure 5: HPCL reported dismal GRM of \$1.1/bbl leading to higher loss



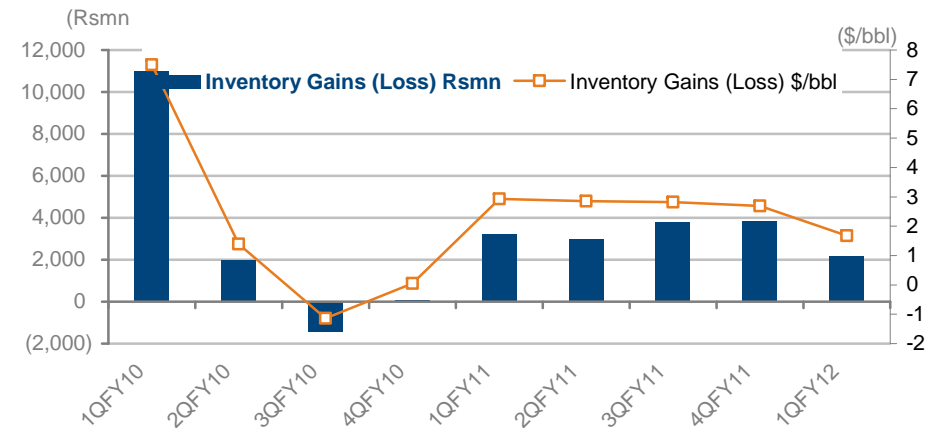
Source: Company, IIFL Research

Figure 6: Utilization rates for both Mumbai and Vizag refinery fell QoQ; Overall 9% decline



Source: Company, IIFL Research

Figure 7: HPCL reported inventory gains of Rs2.2bn



Source: Company, IIFL Research

Valuation summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenues (Rs m)	1,114,679	1,384,928	1,506,561	1,672,298	1,795,889
EBITDA Margins (%)	2.5	2.6	2.6	2.9	3.0
Pre-Exceptional PAT (Rs m)	14,730	17,036	16,696	16,798	19,391
Reported PAT (Rs m)	14,730	17,036	16,696	16,798	19,391
EPS (Rs)	43.5	51.3	49.7	50.0	57.7
Growth (%)	94.6	17.9	-3.0	0.6	15.3
IIFL vs consensus (%)			6.5	-8.3	19.3
PER (x)	8.8	7.5	7.7	7.7	6.7
ROE (%)	12.6	13.2	11.9	11.0	11.7
Debt/Equity (x)	2.0	2.1	2.0	2.0	1.9
EV/EBITDA (x)	13.2	11.5	10.8	9.1	8.4
Price/Book (x)	1.1	1.0	0.9	0.8	0.8

Source: Company data, IIFL Research

Assumptions

Y/e 31 Mar	FY09A	FY10A	FY11A	FY12ii	FY13ii
Crude price (\$/bbl)	84.9	68.7	86.5	90.0	91.8
Under-recoveries (Rs bn)	103	46	78	75	60
Downstream share (%)	0	12.1	8.9	10.0	10.0
Crude processed (mmt)	15.8	15.8	14.8	17.1	17.5
Market sales (mmt)	25.4	26.3	27.1	28.4	29.6
Gross refining margin (Rs bn)	22	14	26	32	35

Source: Company data, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenue	1,114,679	1,384,928	1,506,561	1,672,298	1,795,889
EBITDA	27,674	35,541	39,641	48,880	53,939
EBIT	15,168	20,561	22,340	26,091	29,641
Interest expense	-9,321	-9,105	-10,508	-12,128	-12,449
Exceptional items	0	-328	-149	-149	-149
Others items	18,325	15,076	13,739	12,216	12,320
Profit before tax	24,172	26,204	25,422	26,029	29,364
Tax expense	-9,443	-9,183	-8,742	-9,247	-9,988
Net Profit	14,730	17,036	16,696	16,798	19,391

Cash flow summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
EBIT	15,168	20,561	22,340	26,091	29,641
Depreciation & Amortization	12,505	14,980	17,300	22,790	24,298
Tax paid	-9,443	-9,183	-8,742	-9,247	-9,988
Working capital change	7,271	-27,428	-15,594	-16,328	-9,474
Other operating items	1	-312	-133	-133	-133
Operating Cash-flow	25,503	-1,383	15,171	23,171	34,344
Capital expenditure	-72,936	-34,136	-35,000	-35,000	-35,002
Free cash flow	-47,433	-35,519	-19,829	-11,829	-658
Equity raised	-3,412	-5,126	-16	-16	-17
Investments	32,102	-7,179	0	0	0
Debt financing/disposal	2,752	39,660	17,188	18,000	8,003
Dividends paid	0	0	-4,758	-4,787	-5,527
Other items	2,259	0	0	0	0
Net change in Cash & cash equivalents	-4,729	-2,193	-4,184	1,456	1,673

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Cash & cash equivalents	8,029	5,836	1,652	3,108	4,782
Sundry debtors	27,033	29,197	31,288	33,713	35,484
Trade Inventories	131,050	152,197	172,730	183,855	1,844,663
Other current assets	55,757	65,747	75,747	85,747	95,748
Fixed assets	251,600	270,756	288,456	300,666	311,370
Other assets	96,172	103,350	103,350	103,350	103,350
Total assets	569,640	627,083	673,223	710,440	2,395,397
Sundry creditors	163,119	164,880	179,639	199,176	1,861,133
Other current liabilities	21,253	25,366	27,637	15,321	16,470
Long-term debt/Convertibles	243,364	283,024	300,212	318,212	326,215
Other long-term liabilities	19,123	19,123	19,123	19,123	19,123
Minorities/other Equity	25	10	-6	-21	-37
Networth	122,756	134,681	146,618	158,629	172,492
Total liabilities & equity	569,640	627,083	673,223	710,440	2,395,397

Ratio analysis

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Sales growth (%)	-13.6	24.2	8.8	11.0	7.4
Core EBITDA growth (%)	-15.3	28.4	11.5	23.3	10.3
Core EBIT growth (%)	-31.0	35.6	8.7	16.8	13.6
Core EBITDA margin (%)	2.5	2.6	2.6	2.9	3.0
Core EBIT margin (%)	1.4	1.5	1.5	1.6	1.7
Net profit margin (%)	1.3	1.3	1.1	1.0	1.1
Dividend payout ratio (%)	0.0	0.0	28.5	28.5	28.5
Tax rate (%)	39.1	35.0	34.4	35.5	34.0
Net Debt/Equity (%)	204.8	214.5	205.9	202.6	191.9
Return on Equity (%)	12.6	13.2	11.9	11.0	11.7
Return on Assets (%)	2.8	2.9	2.6	2.4	1.3

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.

SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, i.e. a positive return of 10%+.

Reduce - Stock expected to return less than the hurdle rate, i.e. return of less than 10%.

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