



HPCL

STOCK INFO. BLOOMBERG
BSE Sensex: 20,310 HPCL IN

S&P CNX: 6,122 REUTERS CODE
HPCL.BO

15 November 2010

Buy

Rs464

Previous Recommendation: Buy

Equity Shares (m)	339.0
52-Week Range (Rs)	555/293
1,6,12 Rel. Perf. (%)	-6/20/11
M.Cap. (Rs b)	157.3
M.Cap. (US\$ b)	3.5

YEAR	SALES	ADJ. PAT	ADJ. EPS	EPS	P/E	PI/BY	ROE	ROCE	EVI	EVI
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/09A	1,246,943	4,355	12.8	-40.0	36.1	1.5	4.1	8.8	0.2	8.7
03/10A	1,092,084	13,014	38.4	198.8	12.1	1.4	11.7	8.7	0.2	10.7
03/11E	1,190,702	13,141	38.8	1.0	12.0	1.3	11.0	8.3	0.2	9.0
03/12E	1,146,009	13,649	40.3	3.9	11.5	1.2	10.6	8.7	0.2	7.9

- **Results above estimates, GRM poor:** HPCL reported 2QFY11 EBITDA of Rs23.2b (against our estimate of Rs19.6). Higher-than-estimated EBITDA was due to higher-than-expected government compensation of Rs28.3b (against our estimate of Rs24b) and inventory gains of Rs2.9b, partly offset by lower refinery profits (GRM of US\$2.66/bbl against our estimate of US\$4/bbl and throughput of 3mmt against our estimate of 4mmt). Reported PAT was Rs20.9b (v/s a loss of Rs18.8b in 1QFY11 and Rs1.4b in 2QFY10). 1HFY11 EBITDA was Rs7b and PAT was Rs2b (v/s FY10 EBITDA of Rs25.4b and PAT of Rs13b).
- **Subsidy sharing ad hoc:** In 1HFY11 HPCL's gross under-recoveries were Rs68.3b (Rs24.2b in 2QFY11), of which upstream shared Rs22.8b and government compensated Rs28.3b, resulting in net under-recoveries of Rs17.2b and OMCs (HPCL, BPCL and IOC) shared 26% of the gross under-recoveries (HPCL typically shares 21% of this).
- **Awaiting clarity on diesel deregulation, subsidy rationalization:** After partial deregulation in June 2010, the government has been silent on the next phase of deregulation. While expectations are high for diesel deregulation and subsidy rationalization, we believe the government is having second thoughts on the pace of deregulation due to (1) higher oil prices, (2) forthcoming state elections, and (3) the impact on inflation.
- **Valuation and view:** We model oil marketing companies (HPCL, BPCL and IOC) to share 11% of gross under-recoveries in FY11 and FY12. The stock trades at 12x FY11E cons EPS of Rs38.8 and 1.3x FY11E BV of Rs365.7. Maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

Y/E MARCH	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	241,976	244,566	292,329	313,213	292,199	282,214	290,560	325,729	1,092,084	1,190,702
Change (%)	-30.3	-31.0	-0.5	24.5	20.8	15.4	-0.6	4.0	-12.4	9.0
EBITDA	10,876	-4	1,421	13,139	-16,155	23,224	6,736	18,375	25,432	32,180
% of Net Sales	4.5	0.0	0.5	4.2	-5.5	8.2	2.3	5.6	2.3	2.7
Change (%)	-364.6	-100.0	-69.9	-75.8	-248.5	nm	373.9	39.9	-12.1	26.5
Depreciation	2,629	2,833	3,007	3,175	3,174	3,234	3,500	4,065	11,644	13,973
Interest	2,702	2,493	2,202	1,640	1,968	2,200	2,048	2,232	9,038	8,448
Oil (incl. Oper. other inc)	4,403	3,237	4,373	4,450	2,469	3,817	2,151	1,495	16,463	9,932
Exceptional Item	0	2	0	37	-14	-2			38	-16
PBT	9,948	-2,094	585	12,774	-18,843	21,608	3,339	13,573	21,213	19,677
Tax	3,457	-727	271	5,236	0	712	1,109	4,715	8,237	6,536
Rate (%)	34.8	34.7	46.3	41.0	0.0	3.3	33.2	34.7	38.8	33.2
PAT	6,491	-1,367	314	7,538	-18,843	20,896	2,230	8,857	12,977	13,141
Change (%)	nm	-95.8	nm	-85.2	nm	nm	609.4	17.5	126.0	1.3
Key Assumptions (Rsb)										
Gross under recovery	12	22	29	37	44	24	21	21	100	110
Upstream sharing	2	8	10	14	15	8	7	7	33	37
Oil Bonds/Cash subsidy	0	0	19	37	0	28	11	22	56	61
Net Under recovery	10	15	1	-13	29	-12	3	-8	12	12
Net Sharing (%)	85.1	65.7	2.8	nm	66.7	nm	13.7	nm	12.2	11

E: MOSL Estimates

Operational performance

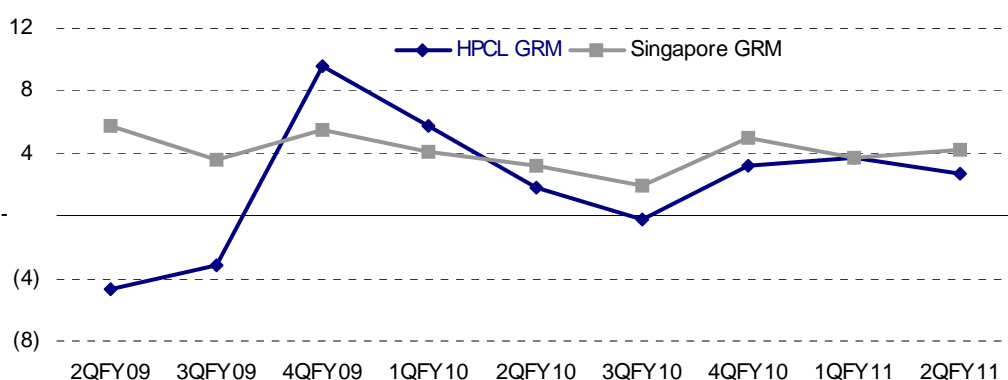
- HPCL reported GRM of US\$2.66/bbl (against our estimate of US\$4/bbl) v/s US\$3.72/bbl in 1QFY11 and US\$1.83/bbl in 2QFY10.
- Combined throughput for the Mumbai and Kochi refinery was 3.04mmt against our estimate of 4mmt (down 24% YoY and 8% QoQ). Volumes were lower due to a shutdown at the Vizag refinery, which spilled over from first quarter to the second quarter.

HPCL: 2QFY11 operational highlights

	FY10				FY11			
	1Q	2Q	3Q	4Q	1Q	2Q	YoY (%)	QoQ (%)
Throughput (mmt)								
Mumbai	1.8	1.8	1.5	1.8	1.2	1.5	-16	24
Visakh	2.3	2.2	2.2	2.1	2.1	1.5	-31	-27
Total	4.1	4.0	3.7	3.9	3.3	3.0	-24	-8
Blended GRM (US\$/bbl)	5.7	1.8	(0.3)	3.2	3.7	2.7	45	-29

Source: Company/MOSL

Except in 1QFY11 HPCL GRM trends below Singapore GRM



Source: Reuters/Company/MOSL

HPCL's subsidy sharing: sharing ad-hoc; expect clarity on sharing towards the end of FY11

	FY10				FY11		2QFY11		FY10 1HFY11	
	1Q	2Q	3Q	4Q	1Q	2Q	YoY (%)	QoQ (%)		
Gross Under recovery	11.6	22.2	29.4	37.2	44.1	24.2	9	-45	100.4	68.3
Less: Sharing										
Upstream Sharing	1.7	7.6	9.6	13.5	14.7	8.1	6	-45	32.5	22.8
Oil Bonds/Cash	0.0	0.0	19.0	36.7	0.0	28.3	nm	nm	55.6	28.3
Net Under/(over) recovery	9.9	14.6	0.8	(13.0)	29.4	(12.2)	-184	-141	12.3	17.2
As a % of Gross	85.1	65.7	2.8	nm	66.7	nm			12.2	25.2

Source: Company/MOSL

Other key highlights

- Gross debt as on September 2010 was Rs224b (v/s Rs213b as on 31 March 2010).

Subsidy sharing ad-hoc: under-recoveries and their sharing (Rs b)

	FY08	FY09	FY10	1QFY11	2QFY11	1HFY11
Fx Rate (Rs/US\$)	40.3	46.0	47.5	45.7	46.6	46.2
Brent (US\$/bbl)	82.3	84.8	69.6	78.5	76.1	77.3
Sharing (Rsb)						
Oil Bonds/Cash	353	713	260	0	130	130
Upstream	257	329	145	67	38	105
OMC's sharing	163	(9)	56	140	(55)	85
Total	773	1,033	461	207	113	319
Sharing (%)						
Oil Bonds	46	69	56	0	115	41
Upstream	33	32	31	32	33	33
OMC's sharing	21	(1)	12	68	(49)	27
Total	100	100	100	100	100	100

Source: Company/MOSL

HPCL: an investment profile

Company description

A Fortune-500 company, HPCL is a refining and marketing company in India and has upstream interests. HPCL 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 16.9% stake in MRPL, a standalone refiner, which it jointly promoted. MRPL is now a subsidiary of ONGC. HPCL is a public sector company, in which the government of India owns 51.11% stake.

Key investment arguments

- HPCL's profitability is determined by the quantum of under-recoveries and sharing mechanism, rather than fundamentals. But recently hopes were rejuvenated by the partial deregulation of automobile fuel. No further policy decision has been taken by the government.
- Medium to long-term growth will come from a 9mmtpa grassroots refinery, being set up in JV (~50% stake) with Mittal Energy Investments with an estimated capex of Rs172b.
- HPCL's valuations are expected to benefit from improvement in (1) earnings quality, (2) RoCE & RoE, (3) cash cycle and (4) lower debt.

Key investment risks

- A delay in 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 the ad-hoc nature of subsidy sharing impacts profits.

Recent developments

- Auto fuel was partially deregulated and prices hiked of domestic fuels in June 2010.

Valuation and view

- The stock trades at 12x FY11E cons EPS of Rs38.8 and 1.3x FY11E BV of Rs365.7. Maintain **Buy**.

Sector view

- The refining outlook is weak given low product demand and new significant capacity hitting the market. We expect refining margins to be subdued in the medium term and expect refinery closures guided by poor refinery economics will lead to rationalization in the demand-supply gap.

Target Price and Recommendation

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

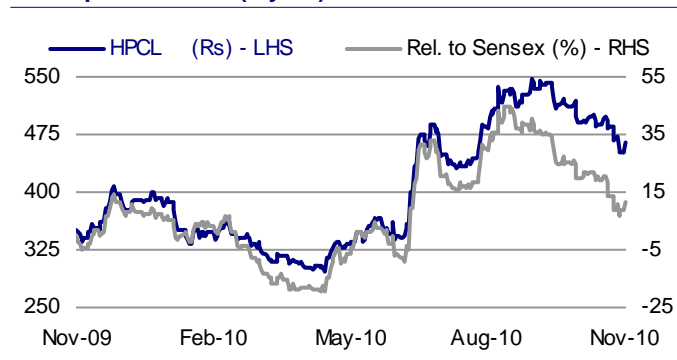
Shareholding Pattern (%)

	Sep-10	Jun-10	Sep-09
Promoter	51.1	51.1	51.1
Domestic Inst	27.9	29.4	28.9
Foreign	9.0	6.8	9.8
Others	12.1	12.8	10.2

EPS: MOSL forecast v/s consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	38.8	43.1	-10.0
FY12	40.3	48.0	-16.0

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT		(RS MILLION)			
Y/E MARCH	2009	2010	2011E	2012E	
Net Sales	1,246,943	1,092,084	1,190,702	1,146,009	
<i>Change (%)</i>	<i>19.1</i>	<i>-12.4</i>	<i>9.0</i>	<i>-3.8</i>	
Finished Gds Purchase	733,373	642,488	750,216	668,099	
Raw Materials Cons	428,320	344,776	367,580	405,364	
Employee Costs	11,372	16,173	17,083	17,254	
Other Exp	44,935	63,215	23,643	19,244	
EBITDA	28,943	25,432	32,180	36,048	
<i>% of Net Sales</i>	<i>2.3</i>	<i>2.3</i>	<i>2.7</i>	<i>3.1</i>	
<i>% Growth</i>	<i>83.7</i>	<i>-12.1</i>	<i>26.5</i>	<i>12.0</i>	
Depreciation	9,813	11,644	13,973	15,276	
Interest	21,073	9,038	8,448	7,875	
Other Income	9,057	16,462	9,933	7,542	
Extraordinary Items (net)		38	-16		
PBT	7,114	21,250	19,677	20,439	
Tax	1,373	8,237	6,536	6,789	
<i>Total Rate (%)</i>	<i>19.3</i>	<i>38.8</i>	<i>33.2</i>	<i>33.2</i>	
Extraordinary - Tax writeback					
PAT	5,741	13,014	13,141	13,649	
Adjusted PAT	4,355	13,014	13,141	13,649	
<i>Change (%)</i>	<i>-61.6</i>	<i>198.8</i>	<i>1.0</i>	<i>3.9</i>	

BALANCE SHEET		(RS MILLION)			
Y/E MARCH	2009	2010	2011E	2012E	
Share Capital	3,390	3,390	3,390	3,390	
Reserves	103,916	112,190	120,571	129,461	
Net Worth	107,306	115,580	123,961	132,851	
Loans	227,552	213,024	190,000	160,000	
Deferred Tax	16,034	18,080	19,500	21,544	
Capital Employed	350,892	346,683	333,461	314,395	
Gross Fixed Assets	202,088	249,884	292,760	330,760	
Less: Depreciation	85,541	96,817	110,790	126,066	
Net Fixed Assets	116,548	153,067	181,970	204,693	
Capital WIP	50,011	38,876	16,000	8,000	
Investments	141,965	113,873	75,447	48,798	
Curr. Assets, L & Adv.	159,926	206,419	193,110	186,930	
Inventory	87,932	125,792	140,659	132,346	
Debtors	22,409	24,373	26,574	25,577	
Cash & Bank Balance	6,083	2,431	2,396	5,526	
Loans & Advances	41,691	52,585	22,244	22,244	
Other Current Assets	1,812	1,237	1,237	1,237	
Current Liab. & Prov.	117,558	165,552	133,067	134,027	
Liabilities	105,382	144,499	114,051	113,931	
Provisions	12,176	21,053	19,016	20,096	
Net Current Assets	42,368	40,867	60,044	52,903	
Application of Funds	350,892	346,683	333,460	314,394	

E: MGRSL Estimates

RATIOS		(RS MILLION)			
Y/E MARCH	2009	2010	2011E	2012E	
Basic (Rs)					
EPS	12.8	38.4	38.8	40.3	
Cash EPS	98.2	113.4	133.7	146.6	
Book Value	316.5	340.9	365.7	391.9	
DPS	5.3	12.0	12.0	12.0	
Payout (incl. Div. Tax.)	27.4	16.1	36.2	34.9	
Valuation (x)					
P/E	36.1	12.1	12.0	11.5	
Cash P/E	4.7	4.1	3.5	3.2	
EV / EBITDA	8.7	10.7	9.0	7.9	
EV / Sales	0.2	0.2	0.2	0.2	
Price / Book Value	1.5	1.4	1.3	1.2	
Dividend Yield (%)	1.1	2.6	2.6	2.6	
Profitability Ratios (%)					
RoE	4.1	11.7	11.0	10.6	
RoCE	8.8	8.7	8.3	8.7	
Turnover Ratios					
Debtors (No. of Days)	5.8	7.8	7.8	8.3	
Asset Turnover (x)	6.3	4.8	4.4	3.7	
Leverage Ratio					
Debt / Equity (x)	2.1	1.8	1.5	1.2	

CASH FLOW STATEMENT		(RS MILLION)			
Y/E MARCH	2009	2010	2011E	2012E	
OP/(Loss) before Tax	7,122	21,250	19,677	20,439	
Depreciation	9,814	11,679	13,973	15,276	
Other op	-26,731	-5,715	-91,574	-45,351	
Interest Paid	20,076	16,075	8,448	7,875	
Direct Taxes Paid	-335	-3,946	-5,116	-4,745	
(Inc)/Dec in Wkg. Capital	48,461	-6,530	-19,212	10,271	
Oil Bonds					
CF from Op. Activity	58,408	32,814	-73,803	3,764	
(Inc)/Dec in FA & C/WIP	-19,275	-36,180	-20,000	-30,000	
(Pur)/Sale of Investments	-69,873	16,601	130,000	72,000	
Loans and Advances					
Inc from Invst	3,187	8,037	0	0	
CF from Inv. Activity	-85,961	-11,542	110,000	42,000	
Issue of Shares	0	0	0	0	
Inc / (Dec) in Debt	56,025	-9,781	-23,024	-30,000	
Interest paid & other Inv	-22,085	-11,224	-8,448	-7,875	
Dividends Paid	-1,194	-2,093	-4,759	-4,759	
CF from Fin. Activity	32,747	-23,097	-36,231	-42,634	
Inc / (Dec) in Cash	5,193	-1,825	-35	3,130	
Add: Op. Balance	2,940	6,083	2,431	2,396	
Bank Balance Adj.	-2,050	-1,826	-1	0	
Closing Balance	6,083	2,431	2,396	5,526	



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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

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