Hindustan Petroleum Corporation

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OIL & GAS/CHEMICALS

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Strong 3Q, but remains in red for 9M FY12

First Look

February 9, 2012

Rating Remains	**Neutral**
Target price Remains	INR 380
Closing price February 8, 2012	INR 286

Research analysts

India Oil & Gas/Chemicals

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Strong 3Q result boosted by higher upstream disc. /govt. subsidy

HPCL reported strong 3QFY12 PAT of INR27.3bn (1HFY12 had losses of INR64.5bn) ahead of our estimate of INR18.6bn. Higher upstream discount at ~47% or INR33.5bn (our est 33% or 22.6bn) and government subsidy at INR65.8bn (our est 65.5bn) boosted the bottom-line. Adjusted for higher upstream discount, numbers were broadly in-line.

Key highlights of 3Q results:

- Gross U/Rs at INR71.3bn increased 108% y-y, 52% q-q. But higher upstream discount and govt. subsidy resulted in improved bottom-line.
- During 3Q upstream companies were made to share higher 47% of gross U/Rs (share in 1HFY12 was 1/3rd).
- Similar to first two quarters of FY12, government agreed to provide INR150bn as compensation for under-recoveries. Oil marketing companies accounted for total INR300bn of government compensation in 3Q (HPCL share 65.8bn) including INR150bn support for 2Q which was announced post 2Q results.
- Operating performance was largely on expected lines.
- Refining margins at US$4.8/bbl also improved ~150% q-q.
- Sharp increase in interest cost at INR7.0bn (up 189% y-y, 131% q-q) is a key concern.

Yet, HPCL remains in red for 9MFY12 with net loss of INR37.2bn

Despite strong 3Q result, HPCL remains in losses for 9M FY12 with net loss of INR37.2bn (vs 9MFY11 /FY11 PAT of INR 4.2bn / 15.4bn). Even as we believe that for the full year FY12, HPCL would come back in profits with govt. / upstream support, profits are likely to remain low and ad-hoc. More than operating performance, under-recoveries and the sharing mechanism continue to be the key determinants of profit (or loss) for HPCL, in our view. The bottom lines of oil marketing companies (OMCs) remain at the mercy of the government-dictated sharing mechanism. And the whole subsidy-sharing process remains quite ad-hoc and non-transparent, in our view.

Subsidy sharing remains a concern, Maintain Neutral

The ad-hoc, non-transparent and uncertain subsidy-sharing process remains a key concern for OMCs. We still believe that for OMCs to emerge as potential long-term investment ideas, further clarity is needed on future steps towards deregulation, as well as sharing mechanism. We remain NEUTRAL on HPCL.

See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 1: HPCL – 3QFY12 results

INR bn	3QFY11	2QFY12	3QFY12F	3QFY12A	y-y %	q-q %	Comments
Sales	**358.4**	**393.1**	495.5	**502.6**	**40%**	**28%**	
Excise Duty	19.4	22.8	27.3	23.5	21%	3%	
Net Sales	**339.0**	**370.3**	468.3	**479.2**	**41%**	**29%**	include govt. support of INR65.8bn.
(Inc)/dec in stock	(16.9)	(9.7)	(5.0)	6.7			
Raw material cons	112.7	146.3	157.2	140.9	25%	-4%	Post upstream discount of INR33.5bn
Staff cost	4.2	4.5	4.5	5.2	22%	15%	
Purchases	216.3	230.0	261.4	263.6	22%	15%	
Other expenditure	16.4	28.7	27.2	27.1	65%	-6%	
Total Expenditure	**332.8**	**399.7**	445.3	**443.4**	**33%**	**11%**	
EBITDA	**6.3**	**(29.4)**	23.0	**35.7**	**470%**	**nm**	In-line post adj. for higher upstream dis.
Depreciation	3.6	4.1	4.2	4.4	20%	5%	
EBIT	**2.6**	**(33.6)**	18.8	**31.4**	**1097%**	**nm**	
Interest	2.4	3.0	3.2	7.0	189%	131%	Sharp increase in interest burden.
Other income	3.0	3.0	3.0	2.9	-4%	-3%	
Profit before tax	**3.2**	**(33.6)**	18.6	**27.3**	**755%**	**nm**	
Tax	1.1	0.0	0.0	0.0			
Net profit	**2.1**	**(33.6)**	18.6	**27.3**	**1191%**	**nm**	**Good 3Q, yet 9M FY12 loss of 37.2bn**
EPS (Reported)	6.2	(99.4)	55.0	80.5	1191%	nm	

Source: Company data, Nomura estimates

Fig. 2: HPCL – Key operating matrix

	3QFY11	2QFY12	3QFY12A	y-y %	q-q %
Refinery Thruput (MMT)	**4.1**	**4.2**	**4.1**	0%	-2%
Market Sales (MMT)	**7.1**	**6.9**	**7.5**	7%	9%
Pipeline throughput (MMT)	**3.2**	**3.3**	**3.5**	8%	5%
Brent (US$/bbl)	86.8	112.5	109.3	26%	-3%
Exchange Rate (INR/US$)	44.9	45.8	50.8	13%	11%
Refining Margin (US$/bbl)					
Singapore Complex	5.5	9.0	8.0	**45%**	**-12%**
Premium/Discount	(0.4)	(7.1)	(3.1)		
HPCL GRM	**5.1**	**1.9**	**4.8**	**-6%**	**150%**
Subsidy sharing (INR bn)					
Gross U/R	**34.3**	**46.9**	**71.3**	**108%**	**52%**
Less: Upstream	11.4	15.6	33.5	193%	115%
Less: Govt compensation	17.5	0.0	65.8	277%	nm
Net U/R	5.4	31.3	-28.1	nm	nm

Source: Company data, Nomura Research

Appendix A-1

Analyst Certification

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Mentioned companies

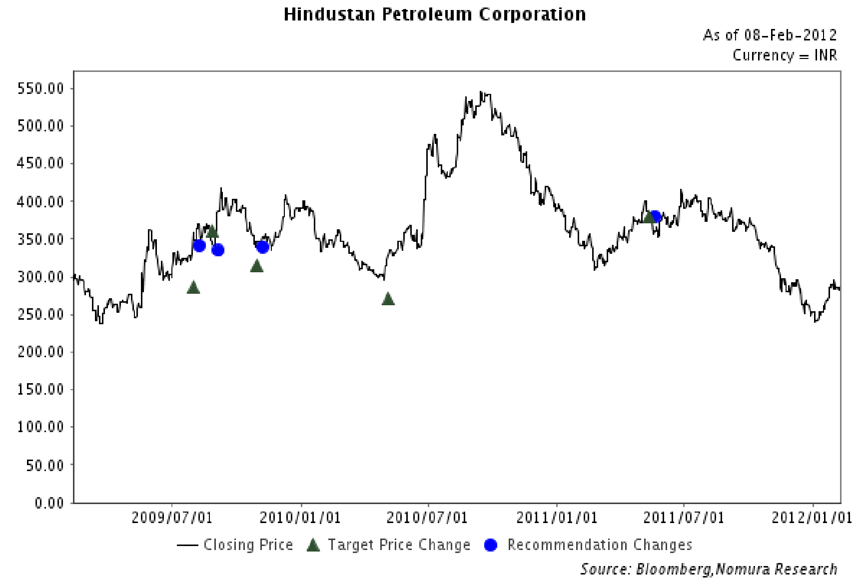
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Hindustan Petroleum Corporation	HPCL IN	INR 286	08-2-2012	Neutral	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Hindustan Petroleum Corporation	Reduce	12-5-2011

Hindustan Petroleum Corporation (HPCL IN) **INR 286 (08-2-2012)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
12-May-11	Neutral		387.85
12-May-11		380.00	387.85
05-May-10		270.00	328.85
29-Oct-09	Reduce		347.45
29-Oct-09		315.00	347.45
27-Aug-09	Neutral		342.40
27-Aug-09		360.00	342.40
31-Jul-09	Reduce		349.25
31-Jul-09		285.00	349.25

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our 12-month target price of INR380 is based on 1.0x FY13F forecast book value per share of INR380.

Risks that may impede the achievement of the target price Key upside risks - Significant change in government policy on fixing retail prices. Complete deregulation would be a significant positive in the long term and could lead to a re-rating. Even partial deregulation, but with a clear policy on sharing of any under-recoveries, would be positive for HPCL, we believe. A significant and sustained decline in global oil prices would also be positive, since losses on retail fuels decline sharply at low oil prices. Refining margins that are higher than our estimates would be positive for HPCL. Key downside risks – Higher oil prices, lower-than-expected refining margins and higher net under-recoveries are key downside risks.

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

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