

July 26, 2010

BUY

Price Rs 436	Target Price Rs 515
Sensex	18,131

Price Performance

(%)	1M	3M	6M	12M
Absolute	21	45	24	35
Rel. to Sensex	19	40	15	13

Source: Bloomberg

Stock Details

Sector	Oil & Gas
Reuters	HPCL.BO
Bloomberg	HPCL@IN
Equity Capital (Rs mn)	3386.2
Face Value(Rs)	10
No of shares o/s (mn)	338.6
52 Week H/L	496/293
Market Cap (Rs bn/USD mn)	148/3,152
Daily Avg Volume (No of sh)	3488943
Daily Avg Turnover (US\$m)	31.9

Shareholding Pattern (%)

	M'10	D'09	S'09
Promoters	51.11	51.11	51.11
FII/NRI	6.79	7.49	11.55
Institutions	29.36	29.07	26.92
Private Corp	6.56	6.02	4.75
Public	6.19	6.31	5.67

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- HPCL reported results which were below our estimates at EBIDTA and PAT Level, primarily due to inventory loss and non-issuance of oil bonds/Cash receivables during the quarter
- Operating profit/ (loss) at (Rs.15.3bn), (against our expectation of (Rs.5.7bn), decline of 215% YoY, mainly due to inventory loss of Rs13.9bn during the quarter
- Average gross refining margin was at \$3.72/bbl as compared to \$5.7/bbl (decline of 34% YoY) in line with our expectation of \$3.7/bbl.
- Valuations look attractive at 1x FY12E ABV, mainly due to recent change in reforms, Continue BUY rating with TP of Rs515

Highlights of the results

HPCL reported results which were below our estimates at EBIDTA and PAT Level, primarily due to inventory loss and non-issuance of oil bonds/cash receivables during the quarter. Revenue for the quarter was at Rs.293bn (against our expectation of Rs.258bn), growth of 20%, mainly on account of higher realizations and higher crude oil prices. EBITDA loss during the quarter was at Rs.15.3bn, decline of 215% on a y-o-y basis. During the quarter Inventory loss were at Rs.13.9bn as compared to inventory gain of Rs.11.1bn in Q4FY10. Interest cost declined by 27.2% to Rs.1.9bn, as debt levels have reduced significantly as compared to last year. During the quarter the company reported net loss of Rs.18.8bn, decline of 390% on a y-o-y basis, mainly due to non-issuance of oil bonds/cash receivables by the government.

The company received upstream discount of Rs. 14.7bn, in respect of crude Oil/LPG/SKO purchased from them has been accounted during the quarter. The company has not received budgetary support from the GOI for the under-recovery of cooking fuel and auto fuel during the quarter.

Better clarity on subsidy sharing mechanism

After years of ad-hoc subsidy arrangements, a proper subsidy sharing mechanism is being worked out. The Oil secretary S Sudarshan has clarified that the 1/3rd of the under recovery would be absorbed by the upstream companies, the government would certainly absorb 50% or more, the balance 17% would be based on the companies performance over the quarter.

Interest cost significantly down

During the quarter, interest costs reduced by 27.2% to Rs.1.9bn as debt on the books have reduced significantly. We believe part of this would be pertaining to the sale of the oil bonds/cash receivables that company has undertaken during the last year.

Average GRM was at \$3.72 per bbl as against \$5.71 per bbl a year ago

Lower product demand, especially in light distillate, has seen product spreads reducing in Q1FY11. Average gross refining margin was at \$3.72/bbl as compared to \$5.7/bbl (decrease of 34% YoY) in line with our expectation of \$3.7/bbl. However, we expect GRM's to improve in the coming quarters, in tandem with the improvement in the global economy, which helps to improve the petro product spreads.

Valuation table

Rs Mn	Net Sales	EBIDTA	EBIDTA (%)	APAT	AEPS	EPS (% chg)	RoE (%)	P/E	EV/EBIDTA	P/BV
FY09	1271091	32655	2.9	7573	22.3	(44.5)	7.0	19.5	7.6	1.3
FY10	1158103	38146	3.4	14761	43.5	94.9	13.2	10.0	6.5	1.2
FY11E	1183804	40343	3.8	17436	51.4	18.1	14.4	8.5	6.2	1.1
FY12E	1232503	43509	3.9	19628	57.9	12.6	14.6	7.5	5.4	1.0

Source: Company, Emkay Research

Valuation attractive, Maintain Buy

Though there has been some clarity on sharing mechanism (upstream companies sharing entire 1/3rd of the total under recovery), more budgetary support from GOI is needed to keep HPCL in black. We expect GOI's budgetary support to increase only if it is able to garner larger funds from disinvestment or by full implementation of Kirit Parekh committee recommendation. At CMP of Rs.436, the stock trades at 1.1x and 1.0x FY11 and FY12 P/BV. We maintain our BUY rating on the stock with target price of Rs.515.

Key financials – Quarterly

Rs mn	Q1 FY10	Q2 FY10	Q3 FY10	Q4 FY10	Q1 FY11	YoY (%)	QoQ (%)
Revenue	244361.5	246289.6	278742	315584.1	293015	19.9	(7.2)
Expenditure	231100	244570.5	275198.4	300074	308354	33.4	2.8
as % of sales	94.6	99.3	98.7	95.1	105.2		
Consumption of RM	215097	227731.9	258984.7	269740.9	295366.8	37.3	9.5
as % of sales	88.0	92.5	92.9	85.5	100.8		
Employee Cost	6057.2	1631	3142.6	5342.4	3662.1	(39.5)	(31.5)
as % of sales	2.5	0.7	1.1	1.7	1.2		
Other expenditure	9945.8	15207.6	13071.1	24990.7	9325.1	-6.2	-62.7
as % of sales	4.1	6.2	4.7	7.9	3.2		
EBITDA	13261.5	1719.1	3543.6	15510.1	(15,339.0)	(215.7)	(198.9)
Depreciation	2628.5	2833.1	3007	3175.4	3174.1	20.8	0.0
EBIT	10633	(1,114.0)	536.6	12334.7	(18,513.1)	(274.1)	(250.1)
Other Income	2017.6	1511.9	2250.4	2079.1	1652.5	(18.1)	(20.5)
Interest	2702.4	2492.9	2202.3	1639.9	1968.3	(27.2)	20.0
PBT	9948.2	(2,095.0)	584.7	12773.9	(18,828.9)	(289.3)	(247.4)
Total Tax	3457	(726.6)	270.7	5235.5	0	(100.0)	(100.0)
Adjusted PAT	6491.2	(1,368.4)	314	7538.4	(18,828.9)	(390.1)	(349.8)
(Profit)/loss from JV's/Ass/MI	-	-	-	-	-		
APAT after MI	6,491.2	(1,368.4)	314.0	7,538.4	(18,828.9)	(390.1)	(349.8)
Extra ordinary items	-	(1.5)	-	(36.9)	14.0		
Reported PAT	6,491.20	(1,366.90)	314.00	7,575.30	(18,842.9)	(390.3)	(348.7)
Reported EPS	19.1	-4.0	0.9	22.2	(55.6)	(391.9)	(350.2)

Margins (%)					(bps)		(bps)
EBIDTA	5.4	0.7	1.3	4.9	(5.2)	(1,066.2)	(1,015.0)
EBIT	4.4	(0.5)	0.2	3.9	(6.3)	(1,066.9)	(1,022.7)
EBT	4.1	(0.9)	0.2	4.0	(6.4)	(1,049.7)	(1,047.4)
PAT	2.7	(0.6)	0.1	2.4	(6.4)	(908.7)	(883.1)
Effective Tax rate	34.8	34.7	46.3	41.0	0.0	(3,475.0)	(4,098.6)

Source: Company, Emkay Research

Key Financials

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
Net Sales	1,271,091	1,158,103	1,183,804	1,232,503
Growth (%)	12.7	(8.9)	2.2	4.1
Expenditure				
Materials Consumed	1,180,167	1,039,098	1,053,492	1,097,681
Employee Cost	11,627	16,428	20,125	20,698
Other Exp	46,643	64,431	69,844	70,615
EBITDA	32,655	38,146	40,343	43,509
Growth (%)	70	17	6	8
EBITDA margin (%)	2.9	3.4	3.8	3.9
Depreciation	10,661	12,505	12,677	12,933
EBIT	21,994	25,641	27,666	30,576
EBIT margin (%)	1.7	2.2	2.3	2.5
Other Income	9,243	7,835	5,462	4,345
Interest expenses	21,123	9,321	7,104	5,624
PBT	10,118	24,154	26,023	29,296
Tax	2,545	9,393	8,588	9,668
Effective tax rate (%)	25.2	38.9	33.0	33.0
Adjusted PAT	7,573	14,761	17,436	19,628
Growth (%)	(44.5)	94.9	18.1	12.6
Net Margin (%)	0.7	1.3	1.6	1.8
(Profit)/loss from JVs/Ass/MI	-	-	-	-
Adjusted PAT After JVs/Ass/MI	7,573	14,761	17,436	19,628
E/O items	-	-	-	-
Reported PAT	7,573	14,761	17,436	19,628
PAT after MI	7,573	14,761	17,436	19,628
Growth (%)	(44.5)	94.9	18.1	12.6

Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
PBT (Ex-Other income)	10,118	24,154	26,023	29,296
Depreciation	10,661	12,505	12,677	12,933
Interest Provided	21,123	9,321	7,104	5,624
Other Non-Cash items	-	-	-	-
Chg in working cap	27,099	(10,173)	(11,593)	(263)
Tax paid	2,153	6,607	8,588	9,668
Operating Cash flow	61,772	21,367	20,162	33,578
Capital expenditure	(30,734)	(13,500)	(14,000)	(14,000)
Free Cash Flow	31,038	7,867	6,162	19,578
Other income	(4,177)	(7,835)	(5,462)	(4,345)
Investments	92,755	40,000	20,000	20,000
Investing Cash flow	-97,095	26,500	6,000	6,000
Equity Capital Raised	-	-	-	-
Loans Taken / (Repaid)	57,207	(39,000)	(24,000)	(37,000)
Interest Paid	(25,862)	(9,321)	(7,104)	(5,624)
Dividend paid (incl tax)	(1,621)	(4,759)	(3,966)	(3,966)
Income from investments	-	-	-	-
Others	-	-	-	-
Financing Cash flow	42,202	-45,245	-29,608	-42,246
Net chg in cash	6,879	2,621	-3,446	-2,668
Opening cash position	2,810	9,688	12,309	8,863
Closing cash position	9,688	12,309	8,863	6,195

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
Equity share capital	3,406	3,406	3,406	3,406
Reserves & surplus	108,023	118,025	131,495	147,158
Net worth	111,429	121,431	134,901	150,564
Minority Interest	27	0	0	0
Secured Loans	17,232	18,232	19,232	20,232
Unsecured Loans	223,380	183,380	158,380	120,380
Loan Funds	240,612	201,612	177,612	140,612
Net deferred tax liability	16,864	16,864	16,864	16,864
Total Liabilities	368,944	339,907	329,377	308,040
Gross Block	219,496	223,496	230,496	239,496
Less: Depreciation	92,873	105,379	118,056	130,989
Net block	126,622	118,117	112,440	108,507
Capital work in progress	64,547	74,047	81,047	86,047
Investment	128,274	88,274	68,274	48,274
Current Assets	174,155	166,834	171,440	173,400
Inventories	91,163	93,764	98,650	101,459
Sundry debtors	24,920	21,638	22,765	23,414
Cash & bank balance	12,763	12,309	8,863	6,195
Loans & advances	1,853	1,617	1,701	1,749
Other current assets	1,853	1,617	1,701	1,749
Current lia & Prov	124,665	113,575	110,035	114,399
Current liabilities	112,294	102,283	98,529	102,453
Provisions	12,371	11,293	11,506	11,946
Net current assets	49,490	53,258	61,405	59,001
Misc. exp	10.5	-	-	-
Total Assets	368,944	339,907	329,377	308,040

Key ratios

Y/E, Mar	FY09	FY10P	FY11E	FY12E
Profitability (%)				
EBITDA Margin	3.7	4.1	4.3	4.3
Net Margin	0.7	1.3	1.6	1.8
ROCE	10.5	9.1	9.7	10.6
ROE	7.0	13.2	14.4	14.6
RoIC	13.5	15.5	16.2	18.3
Per Share Data (Rs)				
EPS	22.3	43.5	51.4	57.9
CEPS	53.8	80.4	88.8	96.1
BVPS	327.2	356.5	396.1	442.1
DPS	5.2	11.9	10.0	10.0
Valuations (x)				
PER	19.5	10.0	8.5	7.5
P/CEPS	8.1	5.4	4.9	4.5
P/BV	1.3	1.2	1.1	1.0
EV / Sales	0.2	0.2	0.2	0.2
EV / EBITDA	7.6	6.5	6.2	5.4
Dividend Yield (%)	2.0	2.7	2.3	2.3
Gearing Ratio (x)				
Net Debt/ Equity	2.0	1.6	1.3	0.9
Net Debt/EBITDA	7.0	5.0	4.2	3.1
Working Cap Cycle (days)	5.7	1.2	4.0	6.9

Recommendation History: HPCL – HPCL IN

Date	Reports	Reco	CMP	Target
27.05.2010	HPCL Q4FY10 Result Update.pdf	Buy	338	515
28.01.2010	HPCL Q3FY10 Result Update.pdf	Buy	344	515
29.10.2009	HPCL Q2FY10 Result Update.pdf	Buy	350	515

Recent Research Reports

Date	Reports	Reco	CMP	Target
28.06.2010	Oil and Gas Event Update			
28.05.2010	BPCL Q4FY10 Result Update	Buy	555	675
01.02.2010	IOCL Q3FY10 Result Update	Buy	311	392

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