

BSE SENSEX 17,831
S&P CNX 5,412

CMP: INR288

Buy

Bloomberg HPCL IN
Equity Shares (m) 339.0
52-Week Range (INR) 420/239
1,6,12 Rel. Perf. (%) 7/-31/-16
M.Cap. (INR b) 97.5
M.Cap. (USD b) 2.0

Year End	Sales (INR m)	Adj. PAT (INR m)	Adj. EPS (INR)	EPS Gr. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/Sales	EV/EBITDA
03/10A	1,092,084	13,014	38.4	198.8	-	-	11.7	8.7	-	-
03/11A	1,309,342	15,390	45.4	18.3	6.3	0.8	12.8	8.6	0.2	8.0
03/12E	1,766,846	9,754	28.8	-36.6	10.0	0.7	7.6	7.0	0.2	8.1
03/13E	1,868,569	11,941	35.2	22.4	8.2	0.7	8.8	7.3	0.1	5.3

- HPCL reported EBITDA of INR35.7b for 3QFY12 (v/s our estimate of EBITDA loss of INR1.3b), primarily due to net over-recovery of INR25b (v/s estimated net under-recovery of INR16.3b), led by higher government compensation. Adjusted for forex loss of INR4b stated in interest expense (earlier used to be component of other expenditure), EBITDA was INR31.7b.
- PAT for the quarter was INR27.3b v/s estimated loss of INR5.9b. Comparative PAT was INR2.1b in 3QFY11 against loss of INR33.6b in 2QFY12.
- Given the ad-hoc subsidy sharing, we believe quarterly financials are not indicative of the likely full-year performance. We now model OMCs' subsidy sharing at nil in FY12 (similar to FY09 v/s 2% earlier) and upstream sharing at ~40%, with the rest being borne by the government.

Net over-recovery, as government compensated for two quarters (2QFY12 and 3QFY12)

- Of the gross under-recovery of INR71.3b in 3QFY12, HPCL received INR33.5b from upstream and INR65.8b from the government. Net subsidy over-recovery was INR28b in 3QFY12.
- The government compensation of INR65.8b was 2x our estimate, because the compensation received is for two quarters (2QFY12 and 3QFY12) v/s our assumption for only one quarter. In 2QFY12, the government had not given any compensation. During the first three quarters of FY12, the government has given a total of INR450b to all the three OMCs (quarterly run rate of INR150b).

Valuation and view

- We model Brent oil price of USD112/100/95/90/bbl in FY12/FY13/FY14/long-term. For FY12/13, we model upstream share at 40%/38.7% and OMCs' share at nil/9%, with the rest being borne by the government.
- The stock trades at 10x FY12E EPS of INR28.8 and 0.7x FY12E BV. Key things to watch (apart from subsidy sharing) are the start of commercial production at the Bhatinda refinery at full utilization levels and GRM performance. Maintain **Buy**.

Quarterly Performance

Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	292,264	281,385	339,025	396,668	407,980	370,302	479,174	509,390	1,309,342	1,766,846
Change (%)	20.8	15.1	16.0	26.6	39.6	31.6	41.3	28.4	19.9	34.9
EBITDA	-16,155	23,224	6,267	19,751	-26,873	-29,437	35,725	55,731	33,088	35,146
% of Net Sales	-5.5	8.3	1.8	5.0	-6.6	-7.9	7.5	10.9	2.5	3.9
Change (%)	-248.5	nm	340.9	50.3	66.3	nm	470.1	182.2	30.1	6.2
Depreciation	3,174	3,234	3,647	4,015	3,886	4,150	4,368	4,422	14,070	16,825
Interest	1,968	2,200	2,417	2,255	2,641	3,028	6,982	2,916	8,840	15,568
Other income	2,469	3,817	2,984	4,165	2,585	2,971	2,876	3,147	13,434	11,579
Exceptional Item	-14	-2		-137	12	0		0	-152	12
PBT	-18,843	21,608	3,188	17,509	-30,803	-33,644	27,252	51,539	23,461	14,345
Tax	0	712	1,078	6,282	0	0	0	4,590	8,071	4,590
Rate (%)	0.0	3.3	33.8	35.9	0.0	0.0	0.0	8.9	34.4	32.0
PAT	-18,843	20,896	2,110	11,227	-30,803	-33,644	27,252	46,949	15,390	9,754
Change (%)	nm	nm	571.2	48.9	63.5	nm	1,191.6	318.2	18.6	-36.6

E: MOSL Estimates

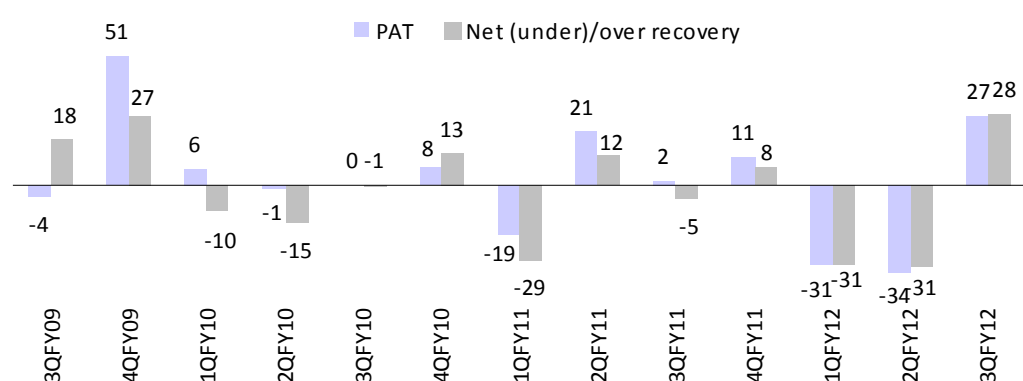
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Other key highlights

- 3QFY12 GRM stood at USD4.8/bbl (v/s est. of USD4.1/bbl) as against USD5.1/bbl in 3QFY11 and USD1.9/bbl in 2QFY12. Product inventory adventitious gain in the quarter stood at INR2.5b (v/s INR3.8b in 3QFY11 and INR8.7b in 2QFY11).
- Refinery throughput stood at 4.1mmt (v/s est. of 4.3mmt), flat YoY and down 3% QoQ. Marketing volumes were up 7% YoY and 9% QoQ to 7.54mmt.
- HPCL's reported interest cost at INR6.9b v/s est of INR3.1b. The difference is on account of adjustment in forex loss of INR4b stated in interest expense which was earlier used to be component of other expenditure (as per ASI 10, now adopted by HPCL). Adjusted interest cost was in-line with our estimate.

Ad-hoc subsidy sharing resulting in volatile quarterly profits (INR b)



Source: Company/MOSL

HPCL's subsidy sharing: Reports over recovery in 3QFY12 due to high government compensation

	FY11				FY12			3QFY12 (%)		FY11	9M FY12
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	YoY	QoQ		
Gross Under recovery	44.1	24.2	34.3	68.6	95.0	46.9	71.3	108	52	171.2	213.2
Less: Sharing											
Upstream Sharing	14.7	8.1	11.4	32.1	31.7	15.6	33.5	193	115	66.3	80.8
Oil Bonds/Cash	0.0	28.3	17.5	44.0	32.7	0.0	65.8	277	nm	89.8	98.6
Net Under/ (over) recovery	29.4	(12.2)	5.4	(7.5)	30.6	31.2	(28.1)	nm	nm	15.1	33.8
As a % of Gross	66.7	nm	15.7	nm	32.2	66.7	(39.4)			8.8	15.9

Source: Company/MOSL

HPCL: 3QFY12 Operational highlights

	FY11				FY12			3QFY12 (%)		FY11	9M FY12
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	YoY	QoQ		
Marketing Volumes (mmt)	6.7	6.0	7.1	7.2	7.3	6.9	7.5	7	9	27.0	21.8
Throughput (mmt)											
Mumbai	1.2	1.5	1.8	2.0	1.8	1.9	1.8	1	-1	6.6	5.5
Visakh	2.1	1.5	2.3	2.4	2.2	2.3	2.2	-2	-4	8.2	6.8
Total	3.3	3.0	4.1	4.3	4.0	4.2	4.1	-1	-3	14.8	12.2
Blended GRM (USD/bbl)	3.7	2.7	5.1	8.6	1.1	1.9	4.8	-6	150	5.3	2.6

Source: Company/MOSL

We model OMCs' sharing at nil in FY12 and 9% in FY13 (INR b)

	FY08	FY09	FY10	FY11	FY12E	FY13E
Fx Rate (INR/USD)	40.3	46.0	47.5	45.6	47.6	50.0
Brent (USD/bbl)	82.3	84.8	69.6	86.3	112.7	100.0
Gross Under recoveries (INR b)						
Auto Fuels	426	575	144	375	750	550
Domestic Fuels	347	458	316	405	566	505
Total	773	1,033	461	780	1,316	1,055
Sharing (INR b)						
Oil Bonds/Cash	353	713	260	410	789	552
Upstream	257	329	145	303	526	409
OMC's sharing	163	-9	56	67	0	94
Total	773	1,033	461	780	1,316	1,055
Sharing (%)						
Government	46	69	56	53	60	52
Upstream	33	32	31	39	40	39
OMC's sharing	21	-1	12	9	0	9
Total	100	100	100	100	100	100

Source: Company/MOSL

Valuation and view

- We model Brent oil price of USD112/100/95/90/bbl in FY12/FY13/FY14/long-term in our estimates. For FY12/13, we model upstream share at 40%/38.7%, OMCs' share at nil/9% and rest to be borne by Government.
- We continue to believe that over the long term, while reforms in the sector are extremely necessary, in the near-term, price hikes are inevitable. We believe that the political compulsion would ease post five state assembly elections making some room for tough decisions in the sector. While, as the headline inflation number has reduced from double digit levels to 7.4% in Dec-11 and moderating, we expect some price hikes to take place.
- The stock trades at 10x FY12E EPS of INR28.8 and 0.7x FY12E BV. Key event to watch (apart from subsidy sharing) is the start of commercial production at Bhatinda refinery at full utilization levels and the GRM performance. Maintain **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 (6.5mmt) 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.
- 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.
- Post de-regulation and subsidy rationalization 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

- The government initiated the process of decontrol of retail fuel prices, starting with petrol prices. The FPO of IOCL and ONGC could be key triggers to start the decontrol process for LPG, kerosene and diesel.

Valuation and view

- The stock trades at 10x FY12E EPS of INR28.8 and 0.7x FY12E BV. Valuations are attractive. Maintain **Buy**.

Sector view

- Global economic environment (particularly Europe) will continue to weigh heavily on refining margins. While economic outlook continues to remain uncertain, we expect GRMs to remain range bound. However, the ceiling will be capped in the near term due to new capacities coming online in FY13 and FY14. We expect the demand-supply gap to correct only through refinery closure of simple refiners and continuous pick-up in global demand.

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
288	-	-	Buy

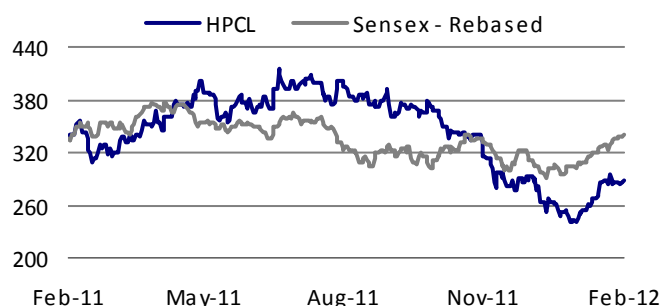
Shareholding pattern (%)

	Dec-11	Sep-11	Dec-10
Promoter	51.1	51.1	51.1
Domestic Inst	27.6	28.6	27.7
Foreign	8.8	9.5	8.6
Others	12.6	10.8	12.6

EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	28.8	36.3	-20.6
FY13	35.2	42.3	-16.8

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Net Sales	1,092,084	1,309,342	1,766,846	1,868,569	
Change (%)	-12.8	19.9	34.9	5.8	
Finished Gds Purchas	642,488	843,135	1,068,237	1,059,850	
Raw Materials Cons	344,776	366,443	576,020	718,619	
Employee Costs	16,173	20,172	18,896	19,274	
Other Exp	63,215	46,505	68,547	25,831	
EBITDA	25,432	33,088	35,146	44,995	
% of Net Sales	2.3	2.5	2.0	2.4	
% Growth	-12.1	30.1	6.2	28.0	
Depreciation	11,644	14,070	16,825	23,592	
Interest	9,038	8,840	15,568	12,800	
Other Income	16,462	13,435	11,579	9,278	
Extraordinary Items (i)	38	-152	12		
PBT	21,250	23,461	14,345	17,881	
Tax	8,237	8,071	4,590	5,939	
Total Rate (%)	38.8	34.4	32.0	33.2	
PAT	13,014	15,390	9,754	11,941	
Adjusted PAT	13,014	15,390	9,754	11,941	
Change (%)	198.8	18.3	-36.6	22.4	

Balance Sheet		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
Share Capital	3,390	3,390	3,390	3,390	
Reserves	112,190	122,068	128,253	135,831	
Net Worth	115,580	125,458	131,643	139,221	
Loans	213,024	250,212	280,000	220,000	
Deferred Tax	18,080	31,956	33,391	35,179	
Capital Employed	346,683	407,626	445,033	394,400	
Gross Fixed Assets	249,884	296,484	344,471	379,471	
Less: Depreciation	96,817	110,039	126,864	150,456	
Net Fixed Assets	153,067	186,445	217,607	229,015	
Capital WIP	38,876	37,987	20,000	15,000	
Investments	113,873	113,350	113,350	113,350	
Curr. Assets, L & Adv.	206,419	265,910	310,704	267,155	
Inventory	125,792	166,223	189,263	198,891	
Debtors	24,373	26,544	35,879	37,945	
Cash & Bank Balance	2,431	800	13,218	2,575	
Loans & Advances	52,585	71,358	71,358	26,759	
Other Current Assets	1,237	985	985	985	
Current Liab. & Prov.	165,552	196,066	216,627	230,120	
Liabilities	144,499	178,018	198,765	210,384	
Provisions	21,053	18,048	17,862	19,735	
Net Current Assets	40,867	69,844	94,076	37,035	
Application of Funds	346,683	407,626	445,034	394,400	

E: MOSL Estimates

Ratios		(INR)			
Y/E March	2010	2011	2012E	2013E	
Basic (INR)					
EPS	38.4	45.4	28.8	35.2	
Cash EPS	113.4	143.0	132.4	167.9	
Book Value	340.9	370.1	388.3	410.7	
DPS	12.0	14.0	9.0	11.0	
Payout (incl. Div. Tax.)	16.1	30.7	36.6	36.5	
Valuation (x)					
P/E	7.5	6.3	10.0	8.2	
Cash P/E	2.5	2.0	2.2	1.7	
EV / EBITDA	8.3	8.0	8.1	5.3	
EV / Sales	0.2	0.2	0.2	0.1	
Price / Book Value	0.8	0.8	0.7	0.7	
Dividend Yield (%)	4.2	4.9	3.1	3.8	
Profitability Ratios (%)					
RoE	11.7	12.8	7.6	8.8	
RoCE	8.7	8.6	7.0	7.3	
Turnover Ratios					
Debtors (No. of Days)	7.8	7.1	6.4	7.2	
Asset Turnover (x)	4.8	4.8	5.5	5.2	
Leverage Ratio					
Debt / Equity (x)	1.8	2.0	2.1	1.6	

Cash Flow Statement		(INR Million)			
Y/E March	2010	2011	2012E	2013E	
OP/(Loss) before Tax	21,250	23,461	14,345	17,881	
Depreciation	11,679	14,082	16,825	23,592	
Other op	-5,715	-2,456	0	0	
Interest Paid	16,075	6,457	15,568	12,800	
Direct Taxes Paid	-3,946	-5,645	-3,156	-4,151	
(Inc)/Dec in Wkg. Cap	-6,530	-25,876	-11,815	46,398	
CF from Op. Activity	32,814	10,024	31,767	96,520	
(Inc)/Dec in FA & CWI	-36,180	-46,101	-30,000	-30,000	
(Pur)/Sale of Investr	16,601	5,371	0	0	
Inc from Invst	8,037	6,919	0	0	
CF from Inv. Activity	-11,542	-33,810	-30,000	-30,000	
Inc / (Dec) in Debt	-9,781	30,408	29,788	-60,000	
Interest paid & other	-11,224	-8,933	-15,568	-12,800	
Dividends Paid	-2,093	-4,731	-3,570	-4,363	
CF from Fin. Activity	-23,097	16,744	10,651	-77,163	
Inc / (Dec) in Cash	-1,825	-7,042	12,418	-10,643	
Add: Op. Balance	6,083	2,431	800	13,218	
Bank Balance Adj.	-1,826	5,410	0	0	
Closing Balance	2,431	800	13,218	2,575	

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HPCL

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