

## UBS Investment Research

# Hindustan Petroleum

### Oil Bonds shore up bottomline

#### ■ Earnings improve qoq, as HPCL accounts for Oil bonds

HPCL reported a PAT of Rs8.5 bn during 2QFY08, down 30% yoy. EBITDA too is lower by 20% at Rs 13 bn (Rs 16bn in 2QFY07) since oil bonds and upstream contribution was lower at 118% of gross under recoveries (133% in 2QFY07). Refining Margin at \$4.2/bbl was up from \$2.6/bbl in 2QFY07.

#### ■ YoY Lower upstream contribution and Oil bonds

HPCL's gross under-recoveries were down 15% yoy to Rs28bn in the quarter, against which it received upstream contribution of Rs9.4bn (Rs13.6 bn in 2QFY07) and oil bonds of Rs23.6 bn (Rs29 bn in 2QFY07). Net over recoveries (i.e. negative under recoveries) were at Rs 5 bn (Rs10 bn in 2QFY07). Inventory gains at Rs1.3bn (Rs0.1 bn in 2QFY07) during 2QFY08 helped partially offset losses in marketing.

#### ■ Outlook still uncertain

We expect the refining segment to gain from a firm refining outlook. However due to the control on auto and cooking fuel prices, the marketing segment will likely continue to suffer losses. Thus, we do not expect the company to benefit fully from the improved refining margin outlook.

#### ■ Valuation

Reiterate Sell rating, PT of Rs240. We remain sceptical about the uncertainties arising out of the government policies on oil bonds and crude oil prices. Our 12-month price target is based on 5x FY08E EV/EBITDA.

Highlights (Rsm)	03/06	03/07	03/08E	03/09E	03/10E
Net Income (UBS)	4,056	15,712	12,706	10,988	-
DACF	10,107	25,922	25,275	24,940	-
CEPS (UBS, Rs)	32.30	67.12	67.87	66.88	-
EPS (UBS, Rs)	11.97	46.35	37.49	32.42	-

Profitability & Valuation	5-yr hist av.	03/07	03/08E	03/09E	03/10E
Production (000 boe/d)	-	-	-	-	-
ROACE %	15.4	16.1	15.2	13.7	-
EV/DACF x	7.7	8.1	7.5	6.7	-
P/CFPS (UBS) x	5.9	4.2	3.5	3.6	-
PE (UBS) x	11.1	6.1	6.3	7.3	-

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs237.50 on 26 Oct 2007 23:39 HKT

Harshad Katkar  
Analyst  
harshad.katkar@ubs.com  
+91-22-2286 2051

Nirmal Raghavan  
Associate Analyst  
nirmal.raghavan@ubs.com  
+91-22-2286 2056

## Global Equity Research

India

Oil Companies, Secondary

12-month rating	<b>Sell</b> <i>Unchanged</i>
12m price target	Rs240.00/US\$6.09 <i>Unchanged</i>

Price Rs237.50/US\$6.02

RIC: HPCL.BO BBG: HPCL IN

29 October 2007

#### Trading data (local/US\$)

52-wk range	Rs333.85-225.50/US\$7.53-5.47
Market cap.	Rs80.5bn/US\$2.04bn
Shares o/s	339m (ORD)
Free float	49%
Avg. daily volume ('000)	239
Avg. daily value (Rsm)	59.7

#### Balance sheet data 03/08E

Shareholders' equity	Rs113bn
P/BV (UBS)	29.2x
Net Cash (debt)	(Rs105bn)

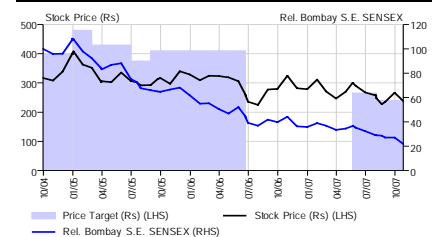
#### Forecast returns

Forecast price appreciation	+1.1%
Forecast dividend yield	0.0%
Forecast stock return	+1.1%
Market return assumption	11.9%
Forecast excess return	-10.8%

#### EPS (UBS, Rs)

	03/08E		Cons.	03/07
	From	To		Actual
Q1E	0.00	0.00	-	0.00
Q2E	0.00	0.00	-	0.00
Q3E	0.00	0.00	-	0.00
Q4E	0.00	0.00	-	0.00
03/08E	37.49	37.49	38.39	
03/09E	32.42	32.42	37.52	

#### Performance (Rs)



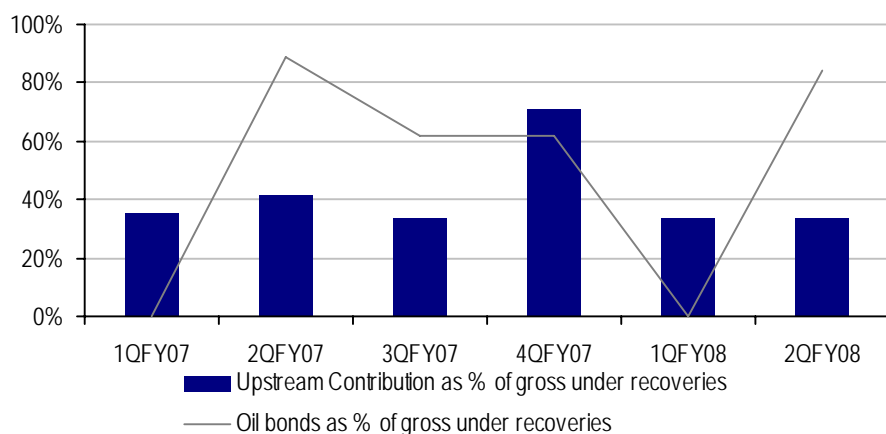
Source: UBS

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Chart 1: HPCL -- Share as % of Under-recoveries



Source: Company

Table 1: HPCL – Quarterly Financials (Rs mn)

	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Net sales	206,741	243,675	221,502	218,495	218,817	242,344
yoy change (%)	37.1%	44.5%	21.3%	4.9%	5.8%	-0.5%
Operating profit	(5,166)	16,462	1,940	10,251	(1,285)	13,176
yoy change (%)	31.3%	2070.4%	-122.1%	-47.5%	-75.1%	-20.0%
Other income	1,021	1,925	2,466	1,964	3,351	2,808
Interest	596	983	1,046	1,527	1,334	1,399
Depreciation	1,701	1,742	1,733	1,864	1,798	2,017
PBT	(6,443)	15,663	1,627	8,824	(1,066)	12,568
Tax rate (%)	5.7	22.0	(150.3)	37.7	18.5	32.1
Tax	(366)	3,443	(2,446)	3,329	-197	4,037
Net profit	(6,077)	12,220	4,073	5,495	(869)	8,530
yoy change (%)	19.6%	-5619.3%	-137.8%	-72.7%	-85.7%	-30.2%
EPS (Rs)	(17.9)	36.1	12.0	16.2	(2.6)	25.2
Cash EPS (Rs)	(12.9)	41.2	17.1	21.7	2.7	31.1

Source: Company

## ■ Hindustan Petroleum

Hindustan Petroleum Corporation Ltd (HPCL) is India's second largest refining and marketing company. It has a total refining capacity of 13 mmtpa, representing 11% of domestic refining capacity. Its refineries are located in western and southern India. HPCL has 20.5% market share of petroleum products in the country. It owns two LPG terminals, two product pipelines and several depots/tankages located across the country.

## ■ Statement of Risk

For HPCL we believe government intervention remains the biggest risk factor in putting a cap on product prices, ie, LPG, kerosene, petrol and diesel. A higher crude price without a corresponding rise in product prices at the retail level is another risk factor. We believe competition from the private sector is a threat in the medium term.

## ■ Analyst Certification

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### UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage <sup>1</sup>	IB Services <sup>2</sup>
Buy	Buy	55%	40%
Neutral	Hold/Neutral	36%	35%
Sell	Sell	9%	22%
UBS Short-Term Rating	Rating Category	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Buy	0%	29%
Sell	Sell	0%	0%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2007.

### UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

## KEY DEFINITIONS

**Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

**Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

**Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

**Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

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**US Closed-End Fund ratings and definitions are:** Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

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**Core Banding Exceptions (CBE):** Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned or Company Disclosure table in the relevant research piece.

## Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Hindustan Petroleum <sup>4</sup>	HPCL.BO	Sell	N/A	Rs237.50	26 Oct 2007

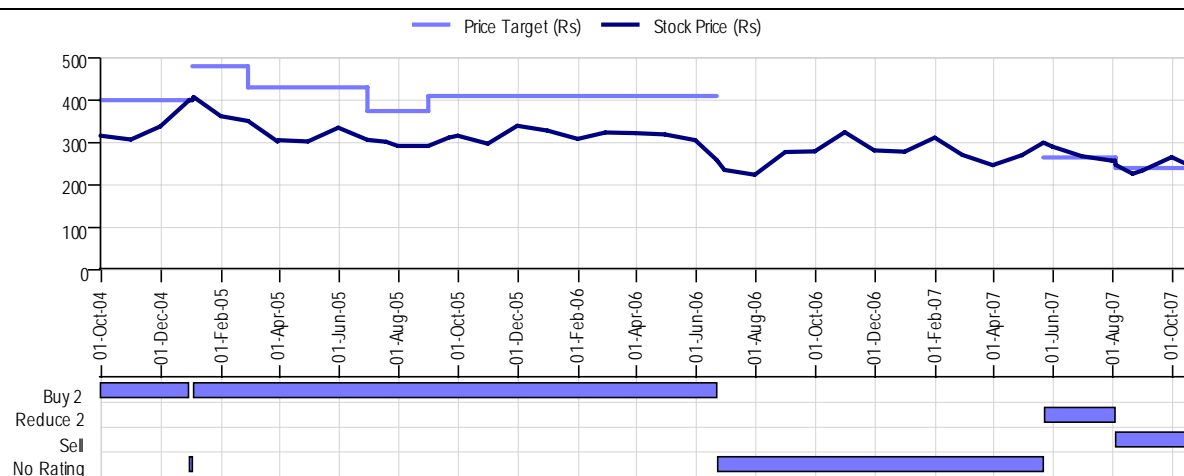
Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

4. Within the past three years, UBS AG, its affiliates or subsidiaries has received compensation for investment banking services from this company/entity.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

## Hindustan Petroleum (Rs)



Source: UBS; as of 26 Oct 2007

Note: On August 4, 2007 UBS revised its rating system. (See 'UBS Investment Research: Global Equity Rating Definitions' table for details). From September 9, 2006 through August 3, 2007 the UBS ratings and their definitions were: Buy 1 = FSR is > 6% above the MRA, higher degree of predictability; Buy 2 = FSR is > 6% above the MRA, lower degree of predictability; Neutral 1 = FSR is between -6% and 6% of the MRA, higher degree of predictability; Neutral 2 = FSR is between -6% and 6% of the MRA, lower degree of predictability; Reduce 1 = FSR is > 6% below the MRA, higher degree of predictability; Reduce 2 = FSR is > 6% below the MRA, lower degree of predictability. The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities. From October 13, 2003 through September 8, 2006 the percentage band criteria used in the rating system was 10%.

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