

Cut FY12 earnings and PO but retain Buy

Cut FY12 EPS by 45% and PO by 11% to Rs384; retain Buy

FY12 earnings outlook of R&M companies in general and that of Hindustan Petroleum (HPCL) in particular has worsened ([Upstream & govt may have to bear most of FY12 subsidy, 03 November 2011](#)). R&M companies including HPCL have been hit by weak refining margins (GRM) in 1H FY12 and worsening subsidy situation. We have therefore cut HPCL's FY12 earnings by 45% to Rs20/share mainly due to cut in GRM. We have also cut HPCL's PO (now at 1x FY12E P/BV) by 11% to Rs384/share. Revised PO implies 33% potential upside. We retain Buy on HPCL.

FY12 EPS cut mainly due to cut in refining margin

HPCL's 1H FY12 GRM was down 53% YoY at US\$1.5/bbl hit by sharp rise in premium it has to pay for light crude like Bonny light. Bonny light or similar domestic crude are around half of HPCL's crude mix. Bonny light-Dubai spread was up to US\$8.8/bbl in 1H FY12 from US\$3.1/bbl in 1H FY11. The premium of indigenous oil (benchmarked to Bonny light), which BPCL uses, to Dubai was US\$10.3/bbl in 1H FY12 vis-à-vis US\$4.0/bbl in 1H FY11.

Revised PO of Rs384/share implies 33% potential upside

We have cut HPCL's FY12 EPS by 45%. We have also cut HPCL's PO by 11% to Rs384/share. The cut in HPCL's PO is more modest than its FY12 EPS. This is because we are now valuing it on 1.0x FY12 P/B rather than on P/E basis given the uncertainty on the FY12 earnings outlook. The only certainty in the uncertain subsidy environment in India is that R&M companies like HPCL would be kept in the black. Thus book value of HPCL will only rise.

Estimates (Mar)

(Rs)	2010A	2011A	2012E	2013E	2014E
Net Income (Adjusted - mn)	17,984	15,542	6,773	15,885	16,356
EPS	53.05	45.60	20.00	46.91	48.30
EPS Change (YoY)	212.8%	-14.0%	-56.1%	134.6%	3.0%
Dividend / Share	14.00	14.00	6.00	17.00	17.00
Free Cash Flow / Share	(35.72)	(97.40)	55.28	59.65	55.18

Valuation (Mar)

	2010A	2011A	2012E	2013E	2014E
P/E	5.30x	6.16x	14.06x	5.99x	5.82x
Dividend Yield	4.98%	4.98%	2.13%	6.05%	6.05%
EV / EBITDA*	4.80x	5.08x	7.55x	5.11x	5.08x
Free Cash Flow Yield*	-12.72%	-34.65%	19.67%	21.22%	19.63%

* For full definitions of *iQmethod*SM measures, see page 5.

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Stock Data

Price	Rs281.10
Price Objective	Rs384.00
Date Established	28-Nov-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs274.00-Rs480.35
Mrkt Val / Shares Out (mn)	US\$1,822 / 338.6
Market Value (mn)	Rs95,189
Average Daily Volume	1,017,810
BofAML Ticker / Exchange	XHTPF / BSE
Bloomberg / Reuters	HPCL IN / HPCL.BO
ROE (2012E)	5.3%
Net Dbt to Eqty (Mar-2011A)	198.8%
Est. 5-Yr EPS / DPS Growth	7.0% / 26.5%
Free Float	49.0%

Key Changes

(Rs)	Previous	Current
Price Obj.	430.00	384.00
2012E EPS	36.23	20.00
2012E EBITDA (m)	34,404.6	26,416.8

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Refer to important disclosures on page 6 to 8. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3. Link to Definitions on page 3. 11114047

iQprofileSM Hindustan Petro.

Key Income Statement Data (Mar)	2010A	2011A	2012E	2013E	2014E
(Rs Millions)					
Sales	1,084,977	1,341,199	1,106,419	1,120,780	1,122,866
Gross Profit	57,776	59,469	44,933	58,825	60,467
Sell General & Admin Expense	(16,173)	(20,172)	(18,517)	(19,813)	(21,200)
Operating Profit	29,959	25,228	10,890	22,970	22,711
Net Interest & Other Income	(1,179)	(1,615)	(930)	391	1,342
Associates	NA	NA	NA	NA	NA
Pretax Income	28,781	23,614	9,960	23,361	24,053
Tax (expense) / Benefit	(10,797)	(8,071)	(3,187)	(7,476)	(7,697)
Net Income (Adjusted)	17,984	15,542	6,773	15,885	16,356
Average Fully Diluted Shares Outstanding	339	339	339	339	339

Key Cash Flow Statement Data

Net Income	17,984	15,542	6,773	15,885	16,356
Depreciation & Amortization	11,644	14,070	15,527	16,042	16,557
Change in Working Capital	NA	NA	NA	NA	NA
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(5,075)	(16,883)	4,433	(1,728)	(4,227)
Cash Flow from Operations	24,553	12,729	26,733	30,199	28,686
Capital Expenditure	(36,661)	(45,711)	(8,013)	(10,000)	(10,000)
(Acquisition) / Disposal of Investments	28,093	522	20,000	20,000	10,000
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(8,568)	(45,189)	11,987	10,000	0
Shares Issue / (Repurchase)	0	(4)	0	0	0
Cost of Dividends Paid	(5,351)	(5,345)	(2,291)	(6,491)	(6,491)
Cash Flow from Financing	(19,879)	31,839	(37,503)	(41,491)	(26,491)
Free Cash Flow	(12,108)	(32,982)	18,720	20,199	18,686
Net Debt	210,592	249,412	212,983	179,274	157,079
Change in Net Debt	(10,633)	37,809	(36,429)	(33,709)	(22,196)

Key Balance Sheet Data

Property, Plant & Equipment	191,943	224,432	216,918	210,876	204,319
Other Non-Current Assets	113,872	113,350	93,350	73,350	63,350
Trade Receivables	24,373	26,544	22,760	23,827	23,622
Cash & Equivalents	2,432	800	2,017	726	2,921
Other Current Assets	179,614	238,566	196,723	206,672	214,398
Total Assets	512,234	603,692	531,768	515,451	508,610
Long-Term Debt	13,759	36,577	30,000	30,000	30,000
Other Non-Current Liabilities	24,475	45,423	45,423	45,423	45,423
Short-Term Debt	199,265	213,635	185,000	150,000	130,000
Other Current Liabilities	159,156	182,600	141,406	150,694	153,987
Total Liabilities	396,655	478,234	401,828	376,117	359,410
Total Equity	115,580	125,458	129,940	139,335	149,200
Total Equity & Liabilities	512,234	603,692	531,768	515,451	508,610

iQmethodSM - Bus Performance*

Return On Capital Employed	6.7%	5.1%	2.2%	4.5%	4.7%
Return On Equity	16.1%	12.9%	5.3%	11.8%	11.3%
Operating Margin	2.8%	1.9%	1.0%	2.0%	2.0%
EBITDA Margin	3.8%	2.9%	2.4%	3.5%	3.5%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.4x	0.8x	3.9x	1.9x	1.8x
Asset Replacement Ratio	3.1x	3.2x	0.5x	0.6x	0.6x
Tax Rate (Reported)	37.5%	34.2%	32.0%	32.0%	32.0%
Net Debt-to-Equity Ratio	182.2%	198.8%	163.9%	128.7%	105.3%
Interest Cover	3.3x	2.9x	1.2x	3.1x	3.5x

Key Metrics

* For full definitions of iQmethodSM measures, see page 5.

Company Description

HPCL is a refining & marketing company and has two refineries with a total capacity of 270kbpd. It also has a 17% stake in MRPL refinery (180kbpd). LPG, kerosene, diesel and gasoline prices (71% of marketing volumes) are regulated, which impacts HPCL's earnings as international oil prices fluctuate. Refining margins, however, track international margins. Govt owns 51% of HPCL.

Investment Thesis

A comprehensive solution to the subsidy problem plaguing HPCL and peers appears unlikely to us in the foreseeable future. HPCL has reported lower earnings than its peers since FY06. Its average refining margin in the last seven years is also lower than peers. HPCL has a similar number of petrol stations as BPCL but its auto fuel sales volume is 15% lower than that of BPCL. Earnings of peer IOC are more stable than HPCL's.

Stock Data

Price to Book Value 0.7x

Price objective basis & risk

Hindustan Petro. (XHTPF)

Our PO of Rs384 is based on PB of 1.0x on HPCL's FY12E book value. Upside risks: (1) Significant reserve accretion in HPCL's E&P exploration assets in India and abroad (2) Subsidy R&M companies have to bear is lower than assumed by us or oil sector is fully deregulated, and (3) Refining margins are higher than forecast by us. Downside risks: (1) Indian oil sector continues to be regulated and HPCL is not adequately compensated for subsidies it has to bear, and (2) steep decline in regional and hence HPCL's refining margins.

Link to Definitions

Energy

Click [here](#) for definitions of commonly used terms.

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APR - Energy Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Citic Resources	CTJHF	1205 HK	Vitus Leung
	Formosa Plastics	FSAPF	1301 TT	Joon-Ho Lee
	Hindustan Petro.	XHTPF	HPCL IN	Vidyadhar Ginde
	Honam Petrochemical	HBBHF	011170 KS	Kenneth Whee
	Kunlun Energy	CNPXF	135 HK	Vitus Leung
	LG Chem	LGCLF	051910 KS	Kenneth Whee
	Nan Ya Plastics	NNYPF	1303 TT	Joon-Ho Lee
	Oil India Ltd	XLCRF	OINL IN	Vidyadhar Ginde
	Oriental Union Chemical	OLUNF	1710 TT	Joon-Ho Lee
	PetroChina	PCCYF	857 HK	Thomas Wong
	PetroChina - A	PTR	PTR US	Thomas Wong
	PTT Global Chemical PLC	XPGOF	PTTGC TB	Komsun Suksumrun
	Reliance Inds	XRELF	RIL IN	Vidyadhar Ginde
	Reliance Inds -G	RLNIY	RIGD LI	Vidyadhar Ginde
	Sinopec	SNPMF	386 HK	Thomas Wong
	Sinopec - A	SNP	SNP US	Thomas Wong
	Sinopec Shanghai Petrochemical	SPTJF	338 HK	Joon-Ho Lee
	SK Innovation	XVERF	096770 KS	Kenneth Whee
	S-Oil	SOOCF	010950 KS	Kenneth Whee
NEUTRAL				
	BPCL	XBPCF	BPCL IN	Vidyadhar Ginde
	CNOOC	CEO	CEO US	Thomas Wong
	CNOOC	CEOHF	883 HK	Thomas Wong
	COSL	CHOLF	2883 HK	Vitus Leung
	Formosa Chemicals & Fibre	XFUMF	1326 TT	Joon-Ho Lee
	Formosa Petrochemical	FPTCF	6505 TT	Kenneth Whee
	MIE Holdings	XMEEF	1555 HK	Vitus Leung
	Sinopec Yizheng Chemical Fibre	YZCFF	1033 HK	Joon-Ho Lee
UNDERPERFORM				
	GS Holdings	GSHDF	078930 KS	Kenneth Whee
	Kolon Industries	XKLNF	120110 KS	Joon-Ho Lee
	KP Chemical	KPCHF	064420 KS	Joon-Ho Lee
	Petronet LNG Ltd	POLNF	PLNG IN	Vidyadhar Ginde
RSTR				
	Cairn India	XCANF	CAIR IN	Vidyadhar Ginde
	IOC	IOCOF	IOCL IN	Vidyadhar Ginde
	ONGC	ONGCF	ONGC IN	Vidyadhar Ginde

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

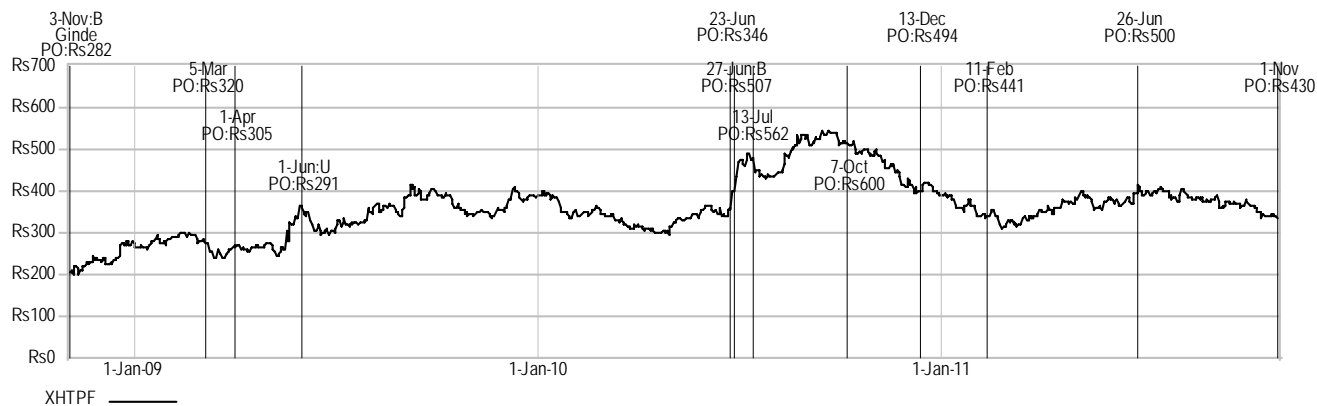
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XHTPF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [October 31, 2011] or such later date as indicated.

Investment Rating Distribution: Energy Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	164	57.95%	Buy	92	60.93%
Neutral	71	25.09%	Neutral	32	55.17%
Sell	48	16.96%	Sell	20	48.78%

Investment Rating Distribution: Global Group (as of 01 Oct 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2073	54.13%	Buy	923	49.12%
Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

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