

BUY

TP: Rs 345 | ▲ 30%

**HINDUSTAN
PETROLEUM CORP**

| Oil & Gas

| 05 August 2021

Q1 muted, project completion the key driver

- Q1 reflects weak benchmark refining margin and impact of planned shutdowns but robust marketing margin
- We believe marketing margin could sustain at historical average levels despite the pause on daily revision of petrol/diesel prices
- Prefer HPCL amongst OMCs as it will be the first to deliver on capex-driven earnings growth over FY23-FY24

Kirtan Mehta, CFA | Kumar Manish
researchreport@bobcaps.in

Refining muted: HPCL's Q1FY22 refining EBITDA was at Rs 0.4bn (or US\$ 0.3/bbl) including inventory gains and reflected 43% lower QoQ throughput due to planned shutdowns and extension of turnaround at the Mumbai refinery and a muted benchmark refining margin. Mumbai refinery will operate at part capacity in Q2 as well, with the restart of CDU2 planned by end-August. Our FY22 estimates were already factoring in a conservative restart for the Mumbai refinery.

Marketing robust: Marketing EBITDA stood at Rs 28.7bn (or Rs 3,255/t) including inventory gains. This reflects a robust marketing margin, offset by a 14% QoQ decline in domestic sales volume. With OMCs pausing daily revision of petrol/diesel prices since mid-July, the question of sustainability of market-determined margins resurfaces. We expect marketing margin to sustain close to the historical average of Rs 2,400/t through the cycle based on our view that crude price will retract to US\$ 65/bbl over H2FY22. We expect the crude balance to turn surplus in CY22 with a gradual lifting of OPEC restrictions and rise in non-OPEC supply.

Prefer HPCL amongst OMCs: We are positive on OMCs given our expectation of a gradual US\$ 3.5/bbl improvement in benchmark refining margin over FY22-FY24 (to US\$ 3.8/bbl) and delivery on refining and petrochemical expansion/upgrade projects. HPCL is positioned to deliver profit growth over FY23-FY24, ahead of other OMCs, from the completion of capex investments worth Rs 320bn on its books and Rs 212bn by HMEL. Key catalysts for the stock hereon are delivery on its Vizag refinery expansion and Bhatinda polymer addition in FY22 as well as the Vizag residue upgrade project in CY22.

Maintain BUY: At 5.4x FY23E EV/EBITDA, HPCL is trading at a discount to BPCL, after adjusting for its investments. Our Mar'22 TP remains at Rs 345 wherein we value the refining and marketing business at 6.0x FY23E EV/EBITDA, in line with our target multiple of 6.0x for OMC peers. For details, please refer to our report [OMCs: Prefer HPCL over BPCL and IOCL, 5 Jul 2021](#).

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	HPCL IN/Rs 265
Market cap	US\$ 5.1bn
Free float	42%
3M ADV	US\$ 21.7mn
52wk high/low	Rs 312/Rs 163
Promoter/FPI/DII	55%/16%/29%

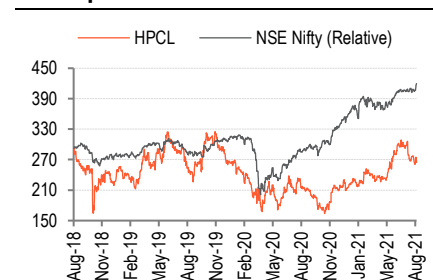
Source: NSE | Price as of 5 Aug 2021

Key financials

Y/E 31 Mar	FY21A	FY22E	FY23E
Total revenue (Rs mn)	23,21,642	30,28,323	31,93,502
EBITDA (Rs mn)	1,49,191	93,158	1,17,631
Adj. net profit (Rs mn)	1,03,856	61,382	82,961
Adj. EPS (Rs)	71.5	42.3	57.1
Consensus EPS (Rs)	71.5	45.1	53.1
Adj. ROAE (%)	30.1	15.4	18.9
Adj. P/E (x)	3.7	6.3	4.6
EV/EBITDA (x)	3.7	6.8	5.4
Adj. EPS growth (%)	139.1	(40.9)	35.2

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

(Rs mn)	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Net Sales	7,21,664	3,74,982	92.5	7,45,446	(3.2)
EBITDA	29,160	41,310	(29.4)	43,676	(33.2)
EBITDA margin (%)	4.0	11.0	-	5.9	-
Depreciation and amortisation	9,139	8,661	5.5	9,372	(2.5)
Interest	2,542	3,217	(21.0)	2,053	23.8
Other income	6,490	7,852	(17.4)	8,434	(23.0)
PBT	23,969	37,284	(35.7)	40,685	(41.1)
Provision for tax	6,019	9,146	(34.2)	10,506	(42.7)
Effective tax rate	25.1	24.5	-	34.6	-
PAT (reported)	17,950	28,138	(36.2)	30,180	(40.5)
NPM (%)	2.5	7.5	-	4.0	-
EPS (adj.) (Rs)	12.6	18.5	(31.8)	20.4	(38.3)

Source: Company, BOBCAPS Research

Fig 2 – Segment performance

	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Crude throughput (t)	2.5	4.0	(36.6)	4.4	(42.8)
GRM (US\$/bbl)	3.3	0.04	8,175.0	8.1	(59.2)
Normalised GRMs (US\$/bbl)	3.3	(0.9)	479.3	3.5	(5.4)
Refining EBITDA (Rs mn)	420	(6,519)	106.5	11,988	(96.5)
Refining EBITDA (US\$/bbl)	0.3	(3.0)	110.5	5.1	(93.9)
Inventory gains/ (loss) (Rs mn)	NA	2,010	-	10,815	-
Inventory gains/ (loss) (US\$/bbl)	NA	0.9	-	4.6	-
Exchange fluctuation gain/(loss) (Rs mn)	(130)	280	-	690	-
Adjusted Refining EBITDA (Rs mn)	NA	(8,809)	-	483	-
Adjusted Refining EBITDA (US\$/bbl)	NA	(4.0)	-	0.2	-
Market sales	8.8	7.6	15.9	10.14	(12.9)
Domestic sales	8.5	7.2	16.7	9.83	(14.0)
Exports	0.4	0.4	-	0.31	22.6
Marketing EBITDA (Rs mn)	28,739	47,829	(39.9)	31,688	(9.3)
Marketing EBITDA (Rs/t)	3,255	6,277	(48.1)	3,125	4.2
Inventory gains/ (loss) (Rs mn)	NA	4,320	-	29,695	-
Inventory gains/ (loss) (Rs/t)	NA	567	-	2,928	-
Exchange fluctuation gain/(loss) (Rs mn)	(580)	210	-	720	-
Adj. Marketing EBITDA (Rs mn)	NA	43,299	-	1,273	-
Adj. Marketing EBITDA (Rs/t)	NA	5,682	-	126	-
Reported EBITDA (Rs mn)	29,160	41,310	(29.4)	43,676	(33.2)

Source: Company

Q1 performance

- HPCL's Q1FY22 headline EBITDA at Rs 29.2bn was in line with consensus (+2%) and net income was 22% ahead at Rs 17.95bn. The company did not disclose benefits of inventory gains this quarter.

Project update

While HPCL is implementing a Rs 320bn capex plan towards Mumbai and Vizag refinery expansion and upgrade, its affiliate HMEL is implementing a Rs 212bn polymer addition project. Management reiterated capex guidance of Rs 145bn each year for FY22 and FY23, tapering down from FY24 onwards.

- **Mumbai refinery:** While CDU1 was brought online in mid-May, CDU2 will be restarted by the end of August. This will increase Mumbai refinery capacity by 2mtpa to 9.5mtpa and improve energy efficiency. A new tankage farm in a nearby area creates scope for further upgrades within the Mumbai refinery.
- **Vizag refinery:** HPCL has spent Rs 150bn out of the budgeted Rs 260bn capex. It is guiding for capacity ramp-up to 13mtpa by end-FY22, then to 15mtpa by end-FY23, and completion of the residue upgrade project in CY22. Management guides that Vizag refinery distillate yield will improve to ~90% and refining margin will expand by US\$ 6/bbl.
- **HMEL Bhatinda refinery polymer addition project:** HMEL is targeting completion of 1.7mtpa of polymer capacity by the end of FY22.
- **Rajasthan refinery:** HPCL has contributed Rs 38bn as equity funding share and will be contributing Rs 60bn-70bn over the next few years. The project is targeted for completion by FY24 with gradual commissioning thereafter.

Valuation methodology

We are positive on OMCs given our expectation of gradual improvement in refining margin and marketing margin holding up. While sustainability of marketing margin is a key risk with the rise in oil prices, we expect crude to retract and remain range bound around US\$ 65/bbl. Divestment of BPCL will be a key catalyst for the sector as it will help establish a value for the marketing business in an attractive growth market like India.

We maintain BUY on HPCL with an unchanged Mar'22 TP of Rs 345, carrying a potential upside of 30%. We value HPCL's refining and marketing business at 6.0x FY23E EV/EBITDA, in line with our target multiple of 6.0x for OMC peers. Completion of Vizag refinery expansion over FY23-FY24 is factored in by valuing incremental earnings at the target multiple and discounting this back to Mar'22. For the polymer addition at Bhatinda refinery as well, we add value for incremental earnings from full ramp-up of the project over FY23-FY24.

Fig 3 – Key assumptions

Parameter	FY21	FY22E	FY23E	FY24E
Refining EBITDA	9	2	21	44
Marketing EBITDA	141	91	96	102
Consolidated EBITDA	149	93	118	145
Growth YoY (%)	-	(37.6)	26.3	23.6
Throughput (mt)	16.5	17.0	21.7	22.5
Growth YoY (%)	(4.1)	2.8	27.6	3.8
Domestic Marketing sales (mt)	35.2	37.9	40.1	42.4
Growth YoY (%)	(6.8)	7.6	5.8	5.8
USDINR exchange rate	74.2	75.0	76.5	78.0
Crude price (US\$/bbl)	67.5	65.0	65.0	65.0
GRM (US\$/bbl)	3.9	2.7	4.3	5.9
Marketing EBITDA (Rs/t)	3,997	2,400	2,400	2,400

Source: Company, BOBCAPS Research

Fig 4 – Valuation summary

Business segments	EV (Rs bn)	Value (Rs/sh)	Comments
Refining standalone	175	121	6x FY23E EBITDA plus value of expansions discounted back to FY22
Marketing	577	397	6x FY23E EBITDA
Refining & Marketing	752	518	
Less: Net Debt	360	248	Adjusted for Bhatinda debt
Bhatinda refinery equity value	20	14	6x FY23E EBITDA plus value of expansions discounted back to FY22
Equity value of core business	412	284	
Investment in MRPL and Oil India	16	11	20% discount to CMP
Other subsidiaries/ JVs/ Affiliates	75	51	At cost
Total equity value for HPCL	503	346	
Target price rounded to nearest Rs 5		345	

Source: BOBCAPS Research

Key risks

OMC valuations are highly sensitive to refining and marketing margins. Key downside/upside risks to our estimates for OMCs are as follows:

- A slower/faster recovery in global economies could lead to below/above-expected refining margins and petrochemical spreads. An adverse/favourable change in global demand-supply balance for the refining or petrochemical product chain could also lower/increase margins vs. our current assumptions.
- Oil prices have surged close to US\$ 75/bbl levels and expose OMCs to the risk of under-recovery on marketing margins for retail sales of petrol/diesel, especially in the wake of recent sharp hikes in excise duties on these fuels.
- Market share losses on fuel product sales could result in below-expected volumes and affect marketing business earnings.
- Refiners are exposed to the requirement of additional investments to lower their carbon footprint, including potential investments in green hydrogen.

HPCL-specific risks:

- Delay in implementation of Vizag refinery expansion and residue upgrade projects could impact earnings growth from this refinery.
- Delay in normalisation of heavy-sour spreads could also have an impact on expected earnings growth from Vizag.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
Bharat Petroleum Corp	BPCL IN	13.3	454	518	HOLD
Hindustan Petroleum Corp	HPCL IN	5.1	265	345	BUY
Indian Oil Corp	IOCL IN	13.2	104	135	BUY

Source: BOBCAPS Research, NSE | Price as of 5 Aug 2021

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	26,79,238	23,21,642	30,28,323	31,93,502	33,26,654
EBITDA	44,947	1,49,191	93,158	1,17,631	1,45,389
Depreciation	(33,699)	(36,255)	(39,136)	(43,723)	(48,310)
EBIT	11,248	1,12,936	54,022	73,908	97,079
Net interest inc./(exp.)	(11,389)	(9,633)	(11,784)	(12,270)	(12,756)
Other inc./(exp.)	28,494	37,280	35,717	40,880	46,004
Exceptional items	(10,029)	0	0	0	0
EBT	28,354	1,40,583	77,955	1,02,518	1,30,327
Income taxes	12,644	(35,341)	(19,542)	(25,627)	(32,705)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(4,582)	1,387	(2,969)	(6,070)	(8,161)
Reported net profit	35,551	1,03,856	61,382	82,961	1,05,783
Adjustments	0	0	0	0	0
Adjusted net profit	45,580	1,03,856	61,382	82,961	1,05,783

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	1,14,726	1,77,987	1,80,349	1,88,321	1,94,071
Other current liabilities	35,077	64,494	65,649	68,796	71,154
Provisions	26,852	28,839	28,839	28,839	28,839
Debt funds	3,93,858	4,26,741	4,21,741	4,61,741	4,56,741
Other liabilities	2,88,780	2,62,729	2,66,761	2,72,049	2,78,798
Equity capital	15,242	14,524	14,524	14,524	14,524
Reserves & surplus	2,94,564	3,66,285	4,00,477	4,47,752	5,07,653
Shareholders' fund	3,09,806	3,80,809	4,15,001	4,62,277	5,22,177
Total liab. and equities	11,69,099	13,41,597	13,78,340	14,82,022	15,51,780
Cash and cash eq.	2,231	5,749	7,545	4,918	6,343
Accounts receivables	39,342	68,700	58,085	61,253	63,807
Inventories	1,93,260	2,87,639	2,25,436	2,35,401	2,42,589
Other current assets	1,29,094	66,095	66,095	66,095	66,095
Investments	1,43,956	1,50,934	1,75,934	2,00,934	2,25,934
Net fixed assets	4,89,351	5,05,903	5,50,167	5,89,844	6,24,934
CWIP	1,71,698	2,53,360	2,91,860	3,20,360	3,18,860
Intangible assets	167	3,216	3,216	3,216	3,216
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	11,69,099	13,41,597	13,78,340	14,82,022	15,51,780

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	48,911	1,13,478	1,45,168	89,078	1,13,203
Capital expenditures	(1,79,253)	(1,34,469)	(1,21,900)	(1,11,900)	(81,900)
Change in investments	(1,051)	(5,131)	(25,000)	(25,000)	(25,000)
Other investing cash flows	28,564	35,432	35,717	40,880	46,004
Cash flow from investing	(1,51,740)	(1,04,168)	(1,11,183)	(96,020)	(60,896)
Equities issued/Others	0	(718)	0	0	0
Debt raised/repaid	1,33,493	32,883	(5,000)	40,000	(5,000)
Interest expenses	0	0	0	0	0
Dividends paid	(17,383)	(38,660)	(27,189)	(35,686)	(45,882)
Other financing cash flows	(5,467)	702	0	0	0
Cash flow from financing	1,10,643	(5,793)	(32,189)	4,314	(50,882)
Chg in cash & cash eq.	7,814	3,518	1,796	(2,628)	1,425
Closing cash & cash eq.	9,999	5,749	7,545	4,918	6,343

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	23.3	71.5	42.3	57.1	72.8
Adjusted EPS	29.9	71.5	42.3	57.1	72.8
Dividend per share	9.7	22.8	16.0	21.0	27.0
Book value per share	203.3	262.2	285.7	318.3	359.5

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	0.2	0.2	0.2	0.2	0.2
EV/EBITDA	10.5	3.7	6.8	5.4	4.3
Adjusted P/E	8.9	3.7	6.3	4.6	3.6
P/BV	1.3	1.0	0.9	0.8	0.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	248.7	73.9	78.7	80.9	81.2
Interest burden (PBT/EBIT)	162.9	124.5	144.3	138.7	134.2
EBIT margin (EBIT/Revenue)	0.4	4.9	1.8	2.3	2.9
Asset turnover (Rev./Avg TA)	238.9	184.9	222.7	223.3	219.3
Leverage (Avg TA/Avg Equity)	3.7	3.6	3.4	3.3	3.1
Adjusted ROAE	14.9	30.1	15.4	18.9	21.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(2.3)	(13.3)	30.4	5.5	4.2
EBITDA	(56.3)	231.9	(37.6)	26.3	23.6
Adjusted EPS	(5.7)	139.1	(40.9)	35.2	27.5
Profitability & Return ratios (%)					
EBITDA margin	1.7	6.4	3.1	3.7	4.4
EBIT margin	0.4	4.9	1.8	2.3	2.9
Adjusted profit margin	1.7	4.5	2.0	2.6	3.2
Adjusted ROAE	14.9	30.1	15.4	18.9	21.5
ROCE	1.8	11.2	4.9	6.3	7.6
Working capital days (days)					
Receivables	7	8	8	7	7
Inventory	122	268	149	107	105
Payables	20	25	22	22	22
Ratios (x)					
Gross asset turnover	4.6	3.5	4.2	3.9	3.7
Current ratio	1.1	1.0	0.8	0.8	0.9
Net interest coverage ratio	1.0	11.7	4.6	6.0	7.6
Adjusted debt/equity	1.3	1.1	1.0	1.0	0.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

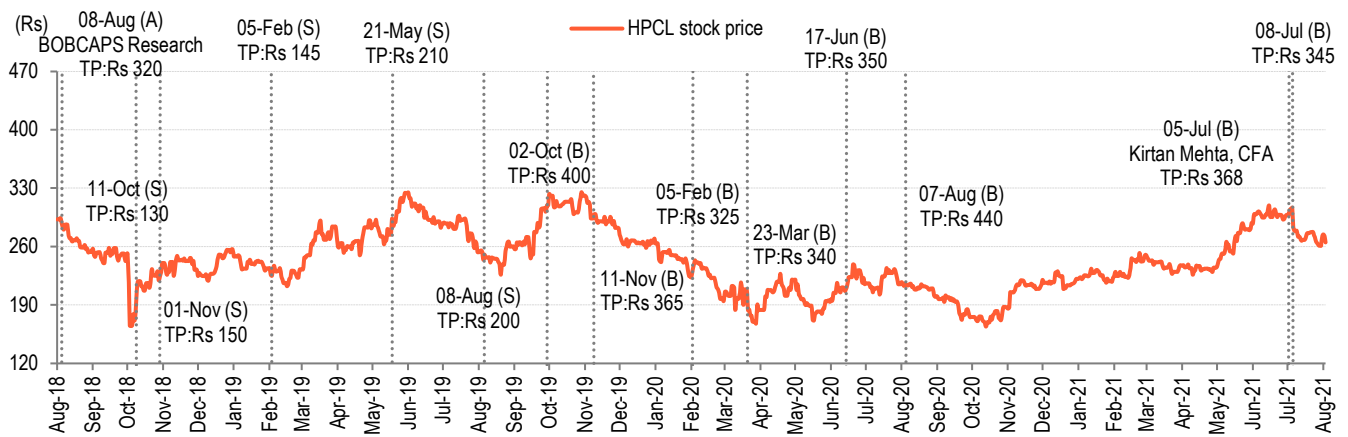
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): HINDUSTAN PETROLEUM CORP (HPCL IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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