

BUY
TP: Rs 480 | ▲ 35%

**BHARAT PETROLEUM
CORP**

Oil & Gas

30 October 2020

Robust fundamentals

BPCL's Q2FY21 earnings were in line, driven by recovery in core GRMs (US\$ 1.56/bbl, ex-inventory gains) and robust marketing margins. EBITDA was in-line at Rs 39bn (+62% YoY), spurred by the marketing segment while refining losses continued. Marketing volumes and refining throughput improved QoQ as demand began returning to normal. With strong marketing margins and recovery in benchmark GRMs, BPCL's FY21-FY23 earnings outlook has improved. Our Sep'21 TP remains at Rs 480 – maintain BUY.

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GRMs outperform: BPCL's reported GRMs came in ahead of expectations at US\$ 5.8/bbl (incl. inventory gains of US\$ 4.2/bbl), beating the Singapore benchmark of US\$ 0.1/bbl. Kochi margins outperformed the company average at US\$ 6.9/bbl as distillate yields improved. Benchmark GRMs have recently turned positive (~US\$ 2/bbl since Oct'20) as the world gradually emerges out of pandemic-induced lockdowns. We expected GRMs to normalise to pre-Covid levels by Q4FY21.

Ticker/Price	BPCL IN/Rs 354
Market cap	US\$ 9.4bn
Shares o/s	1,967mn
3M ADV	US\$ 53.7mn
52wk high/low	Rs 549/Rs 252
Promoter/FPI/DII	53%/12%/35%

Source: NSE

Marketing earnings remain elevated: Q2 marketing business earnings (implied from GRM data) remained robust at Rs 17bn (Rs 1,831/mt, ex-Rs 11.5bn of inventory gains), normalising from an exceptionally high Q1. Domestic sale volumes beat estimates at 8.9mt (-13% YoY, +19% QoQ). Sales of petrol and diesel have reached pre-Covid levels from Oct'20. Although management has guided for stable marketing margins over H2FY21, prospects for Q3 look better given the decline in oil prices.

STOCK PERFORMANCE



Source: NSE

Divestment could drive valuations: At 8.7x FY22E EBITDA, BPCL's valuations remain at a premium to OMC peers in the run-up to conclusion of its divestment. The stock also looks lucrative given potential cash proceeds from divestment of Numaligarh Refinery (Rs 15bn PAT in FY20) in Dec'20E.

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	2,982,256	2,845,719	2,063,899	2,542,468	3,140,495
EBITDA (Rs mn)	151,122	83,490	155,003	151,260	177,846
Adj. net profit (Rs mn)	85,278	34,851	97,490	84,612	90,449
Adj. EPS (Rs)	43.4	17.7	49.6	43.0	46.0
Adj. EPS growth (%)	(12.9)	(59.1)	179.7	(13.2)	6.9
Adj. ROAE (%)	21.8	8.9	24.9	19.2	18.5
Adj. P/E (x)	8.2	20.0	7.2	8.2	7.7
EV/EBITDA (x)	6.9	13.1	7.8	8.9	7.8

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Net sales	501,464	643,408	(22.1)	387,851	29.3	889,314	1,406,587	(36.8)
EBITDA	38,512	23,749	62.2	39,158	(1.7)	77,670	45,548	70.5
EBITDA margin (%)	7.7	3.7	-	10.1	-	8.7	3.2	-
Depreciation and amortisation	9,888	9,523	3.8	9,959	(0.7)	19,847	18,664	6.3
Interest	126	6,388	(98.0)	5,871	(97.8)	5,998	10,912	(45.0)
Other income	5,726	8,713	(34.3)	5,933	(3.5)	11,659	14,097	(17.3)
PBT	34,223	16,551	106.8	29,262	17.0	63,485	30,069	111.1
Provision for tax	10,500	(533)	(2,068.9)	8,500	23.5	19,000	2,234	750.6
Effective tax rate	30.68	(3.22)	-	29.05	-	29.93	7.43	-
PAT (reported)	22,478	17,085	31.6	20,762	8.3	44,485	27,835	59.8
PAT (adjusted)	23,723	12,187	94.7	20,762	14.3	44,485	20,399	118.1
EPS (adj.)	12.06	6.20	94.7	10.56	14.3	22.62	10.37	118.1
Reported GRMs (US\$/bbl)	5.80	3.38	71.6	0.39	1,387.2	3.19	2.93	9.0
Refining throughput (mmt)	5.63	7.66	(26.5)	5.14	9.5	10.77	15.11	(28.7)
Market sales (mmt)	9.22	10.81	(14.7)	8.32	10.8	17.54	22.15	(20.8)

Source: Company, BOBCAPS Research

FIG 2 – OPERATIONAL PERFORMANCE

	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1 FY20	YoY (%)
Reported GRM (US\$/bbl)	5.8	3.4	71.6	0.4	1,387.2	3.2	2.9	9.0
- Mumbai	4.7	3.7	28.5	0.3	1,412.9	2.5	3.4	(24.9)
- Kochi	6.9	3.1	124.3	0.5	1,314.3	3.9	2.5	57.3
Inventory gains/ (loss) (US\$/bbl)	4.24	(0.4)	-	(1.53)	-	1.5	(0.6)	326.3
Normalised GRMs (US\$/bbl)	1.56	3.8	(59.3)	1.92	(18.9)	1.7	3.6	(51.5)
- Mumbai	2.2	4.1	(45.9)	1.1	95.6	1.7	3.7	(53.7)
- Kochi	0.8	3.5	(76.0)	2.8	(70.0)	1.8	3.4	(48.4)
Crude throughput (MMT)	5.6	7.7	(26.5)	5.1	9.5	10.8	15.1	(28.7)
Adj. Refining EBITDA (Rs mn)	(2,898)	5,238	-	(1,662)	-	(4,554)	8,313	(154.8)
Total market sales (MT)	9.22	10.81	(14.7)	8.32	10.8	17.54	22.15	(20.8)
Market sales (MT) - Domestic	8.9	10.3	(12.8)	7.5	18.7	16.5	21.4	(22.9)
Market sales (MT) - Exports	0.28	0.56	(50.0)	0.79	(64.6)	1.07	0.79	35.4
Marketing EBITDA (Rs mn)	28,380	18,511	53.3	45,200	(37.2)	73,580	37,235	97.6
Marketing EBITDA (Rs/MT)	3,078	1,712	79.8	5,433	(43.3)	4,195	1,681	149.5
Marketing inventory gains/(loss) (Rs mn)	11,500	1,490	671.8	10,030	14.7	21,530	220	-
Adj Marketing EBITDA (Rs mn)	16,880	17,021	(0.8)	35,170	(52.0)	52,050	37,015	40.6
Adj Marketing EBITDA (Rs/MT)	1,831	1,575	16.3	4,227	(56.7)	2,967	1,671	77.6
Total reported EBITDA (Rs mn)	38,512	23,749	62.2	39,158	(1.7)	77,670	45,548	70.5

Source: Company, BOBCAPS Research

FIG 3 – PETROLEUM PRODUCT SALES VOLUME: INDUSTRY VS. BPCL

(tmt)	BPCL QoQ growth (%)	Industry QoQ growth (%)	BPCL YoY growth (%)	Industry YoY growth (%)	BPCL H1FY21 growth (%)	Industry H1FY21 growth (%)
LPG	7.2	5.1	4.7	0.2	7.5	5.8
MS	44.8	41.1	(6.7)	(5.0)	(23.1)	(20.8)
HSD	10.3	5.3	(15.5)	(15.6)	(26.5)	(25.2)
SKO	14.3	(3.0)	(20.0)	(24.2)	(34.8)	(33.0)
ATF	100.0	107.3	(61.7)	(60.3)	(72.4)	(70.5)
Others	28.4	7.7	(16.4)	(3.3)	(26.2)	(7.3)
Total domestic sales	18.7	11.3	(12.8)	(10.1)	(22.9)	(17.6)

Source: Company, BOBCAPS Research

Earnings call highlights

- MS and HSD sales have now reached levels last seen in Oct'19, which indicates a return to pre-Covid normalcy. However, ATF sales still lag as international flight operations have not resumed fully (BPCL's ATF sales are mostly for international flights).
- At the refining level, 83% of capacity has been reached.
- Management believes that marketing margins should be studied from a longer-term perspective and does not expect the exceptionally high margins seen last quarter to continue. Instead, it finds current levels of ~Rs 1800/mt (adjusted for Rs11 bn inventory gains) sustainable.
- Inventory gains during the current quarter (~US\$ 4.2/bbl) occurred due to procurement of crude at lower prices.
- GRMs of the Bina and Numaligarh refineries were at US\$ 11/bbl and US\$ 38/bbl respectively in Q2. There was an excise duty hike at Numaligarh refinery, of which 50% is being retained by BPCL, leading to higher profit at Rs 8.4bn. Net profit for Bina refinery stood at Rs 2.3bn for the quarter.
- Middle distillate have a 55% share of refining product output from refineries. HSD forms the highest portion at 49% of total output, MS (petrol) at 20%, naphtha at 7% and LPG at 5%.
- Over the longer term of 10-15 years, management sees HSD sales growing at 3-4% and MS sales growing at 7-8%.
- BPCL plans to add 6,000 retail outlets over the next three years. In H1FY21, 926 retail outlets were added out of a total of ~1,800 planned for FY21.
- No major capex is proposed on the EV side. At Mozambique, BPCL's share of capex is earmarked at US\$ 2.5bn. An outlay of Rs 100bn-120bn is planned for the gas subsidiary.

Valuation methodology

Given that benchmark GRMs remain muted, BPCL's marketing segment provides strong hope for sustenance of earnings and ROE (>20% levels). At 8.7x FY22E EBITDA, BPCL's valuations remain at a significant premium to OMC peers in the run-up to potential clarity on international bids for its divestment. The stock also looks lucrative given potential cash proceeds from divestment of Numaligarh Refinery (Rs 15bn PAT in FY20) in Dec'20E. Maintain BUY with an unchanged Sep'21 SOTP-based target price of Rs 480.

Our SOTP valuation is arrived at as follows:

- refining businesses valued at 6x Sep'22E EBITDA,
- marketing business at 5x Sep'22E EBITDA,
- other investments in listed entities valued at 20% discount to CMP, and
- E&P business valued at an EV/boe of US\$ 1 and US\$ 4/boe for yet-to-be developed reserves in Mozambique and Brazil respectively. Note that execution troubles and low oil prices could extend the delays in production start-up to well beyond 2023.

FIG 4 – VALUATION SUMMARY

Business segments	EV (Rs/bn)	Value (Rs/share)	Comments
Refining			
Standalone	71	36	6x Sep'22E EBITDA
BORL refinery	182	92	6x Sep'22E EBITDA
Numaligarh	185	94	6x Sep'22E EBITDA
Marketing	666	339	5x Sep'22E EBITDA
Total core business	1,104	561	
Less: Net Debt	308	157	Adjusted for consolidation
Equity value of core business	796	405	
Total investments value	105	53	Investments in PLNG, OINL, IGL @ 20% discount to CMP
Total E&P	40	20	Brazil at EV/boe of US\$ 4, Mozambique at EV/boe of US\$ 1
Total equity value for BPCL	939	480	At 11x FY22E EPS

Source: BOBCAPS Research

FIG 5 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Global slowdown:** BPCL’s valuations are highly sensitive to GRMs and marketing margins. An elongated slowdown in global economies (and consequently the Indian economy) could lead to below-expected spreads and alter our valuation outlook.
- **Surge in oil prices:** A surge in oil prices (to >US\$ 70/bbl levels) could provoke a change in government regulation on marketing margins for retail sales of petrol/diesel, especially in the wake of recent sharp hikes in excise duties on these fuels. Marketing business earnings could be severely affected by this.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	2,982,256	2,845,719	2,063,899	2,542,468	3,140,495
EBITDA	151,122	83,490	155,003	151,260	177,846
Depreciation	(34,178)	(40,801)	(40,061)	(43,137)	(46,212)
EBIT	116,945	42,689	114,942	108,122	131,634
Net interest income/(expenses)	(17,640)	(26,370)	(31,671)	(39,417)	(45,770)
Other income/(expenses)	20,375	19,293	37,582	31,902	23,048
Exceptional items	0	(13,103)	0	0	0
EBT	119,680	35,613	120,854	100,608	108,913
Income taxes	(43,775)	142	(35,350)	(29,252)	(31,720)
Min. int./Inc. from associates	9,373	(14,007)	(11,986)	(13,256)	(13,256)
Reported net profit	85,278	36,658	97,490	84,612	90,449
Adjusted net profit	85,278	34,851	97,490	84,612	90,449

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	173,847	131,072	133,265	191,153	238,303
Other current liabilities	211,450	297,596	252,092	158,046	196,910
Provisions	35,662	15,960	15,960	15,960	15,960
Debt funds	429,145	616,482	685,744	735,744	735,744
Other liabilities	67,920	61,639	60,841	60,022	59,182
Equity capital	19,669	19,669	19,669	19,669	19,669
Reserves & surplus	398,023	345,654	397,209	445,231	495,574
Shareholders' fund	417,692	365,322	416,878	464,899	515,243
Total liabilities and equities	1,356,417	1,508,635	1,585,344	1,646,389	1,781,905
Cash and cash eq.	6,625	11,648	5,781	22,605	11,816
Accounts receivables	69,063	53,780	38,631	47,708	59,047
Inventories	229,349	222,425	230,651	172,038	214,472
Other current assets	124,789	107,462	107,462	107,462	107,462
Investments	249,069	270,285	334,700	400,964	469,079
Net fixed assets	493,146	601,417	635,974	667,454	695,860
CWIP	141,547	177,896	168,424	164,436	160,449
Deferred tax assets, net	4,537	13,848	13,848	13,848	13,848
Other assets	38,293	49,873	49,873	49,873	49,873
Total assets	1,356,417	1,508,635	1,585,344	1,646,389	1,781,905

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	119,456	77,459	137,551	127,749	136,661
Changes in working capital	(30,585)	42,309	(36,388)	13,379	32,240
Other operating cash flows	(7,679)	(12,471)	(38,380)	(32,721)	(23,888)
Cash flow from operations	81,192	107,297	62,783	108,407	145,013
Capital expenditures	(114,543)	(185,421)	(65,146)	(70,630)	(70,630)
Change in investments	(11,823)	(21,216)	(64,415)	(66,265)	(68,115)
Other investing cash flows	20,375	19,293	37,582	31,902	23,048
Cash flow from investing	(105,991)	(187,343)	(91,978)	(104,993)	(115,697)
Debt raised/repaid	50,009	187,337	69,262	50,000	0
Dividends paid	(43,724)	(17,266)	(45,935)	(36,590)	(40,106)
Other financing cash flows	11,601	(85,001)	0	0	0
Cash flow from financing	17,886	85,070	23,328	13,410	(40,106)
Changes in cash and cash eq.	(6,913)	5,024	(5,868)	16,825	(10,790)
Closing cash and cash eq.	6,625	11,649	5,781	22,605	11,816

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	43.4	18.6	49.6	43.0	46.0
Adjusted EPS	43.4	17.7	49.6	43.0	46.0
Dividend per share	19.0	7.5	20.0	15.9	17.4
Book value per share	212.4	185.7	211.9	236.4	262.0

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.4	0.4	0.6	0.5	0.4
EV/EBITDA	6.9	13.1	7.8	8.9	7.8
Adjusted P/E	8.2	20.0	7.2	8.2	7.7
P/BV	1.7	1.9	1.7	1.5	1.4

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	71.3	154.8	80.7	84.1	83.0
Interest burden (PBT/EBIT)	102.3	52.7	105.1	93.1	82.7
EBIT margin (EBIT/Revenue)	3.9	1.5	5.6	4.3	4.2
Asset turnover (Revenue/Avg TA)	232.9	198.7	133.4	157.3	183.2
Leverage (Avg TA/Avg Equity)	3.3	3.7	4.0	3.7	3.5
Adjusted ROAE	21.8	8.9	24.9	19.2	18.5

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	26.5	(4.6)	(27.5)	23.2	23.5
EBITDA	(0.4)	(44.8)	85.7	(2.4)	17.6
Adjusted EPS	(12.9)	(59.1)	179.7	(13.2)	6.9
Profitability & Return ratios (%)					
EBITDA margin	5.1	2.9	7.5	5.9	5.7
EBIT margin	3.9	1.5	5.6	4.3	4.2
Adjusted profit margin	2.9	1.2	4.7	3.3	2.9
Adjusted ROAE	21.8	8.9	24.9	19.2	18.5
ROCE	9.1	4.6	7.7	6.5	7.5
Working capital days (days)					
Receivables	7	8	8	6	6
Inventory	32	33	44	32	24
Payables	20	20	25	25	26
Ratios (x)					
Gross asset turnover	3.7	3.1	2.0	2.3	2.7
Current ratio	0.8	0.6	0.7	0.6	0.6
Net interest coverage ratio	6.6	1.6	3.6	2.7	2.9
Adjusted debt/equity	1.0	1.7	1.6	1.5	1.4

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

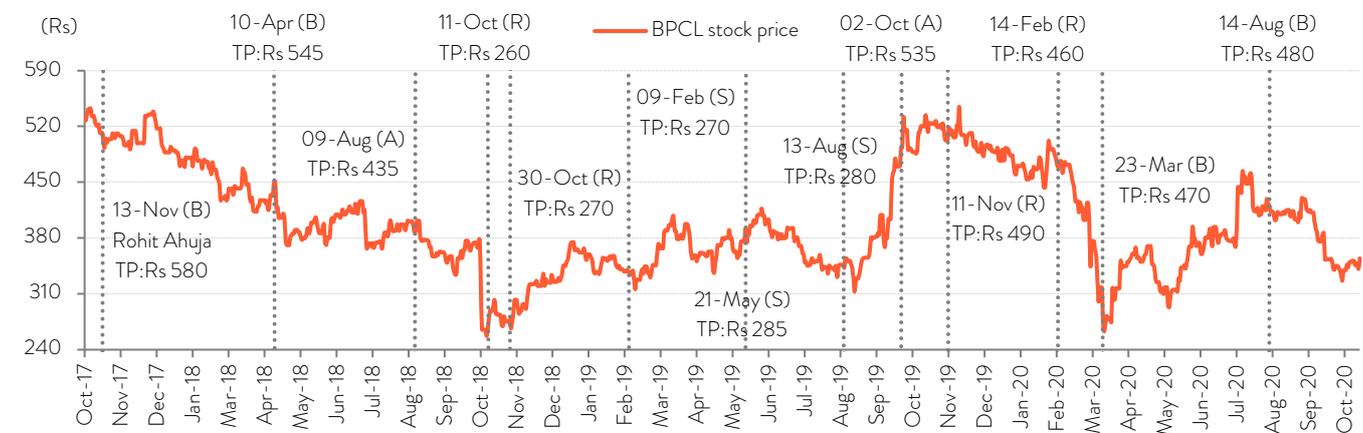
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): BHARAT PETROLEUM CORP (BPCL IN)



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

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