

SELL

TP: Rs 200 | ▼ 18%

**HINDUSTAN
PETROLEUM CORP**

Oil & Gas

08 August 2019

Near-term outlook remains bleak

HPCL's Q1FY20 earnings at Rs 8.1bn (-52% YoY) came in below estimates, marred by low GRMs (US\$ 0.75/bbl, after US\$ 2.6/bbl inventory loss).

Marketing segment EBITDA at Rs 20.3bn (-27% YoY) was in line. We trim FY20 earnings by 3.7% on reduced GRM assumptions. A challenging macro environment for cyclicals exposes less efficient refiners to earnings shocks, offsetting gains from low oil prices. Our SOTP-based TP changes to Rs 200 (from Rs 210) as we roll forward to Sep'21 valuations. Maintain SELL.

Rohit Ahuja | Harleen Manglani

research@bobcaps.in

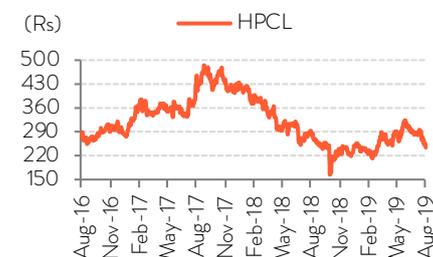
GRMs underperform on surprise inventory loss: HPCL's reported GRMs at US\$ 0.75/bbl were well below estimates due to an inventory loss of US\$ 2.6/bbl. While Singapore GRMs have recovered to ~US\$ 6/bbl in Jul'19, negative light-heavy crude spreads limit HPCL's capability to improve its margins. We cut FY20E GRMs to US\$ 5/bbl but remain constructive on the outlook over FY21-FY22 (maintaining our estimates at US\$ 6/bbl), anticipating benefits from IMO regulations starting in CY20.

Ticker/Price	HPCL IN/Rs 244
Market cap	US\$ 5.3bn
Shares o/s	1,524mn
3M ADV	US\$ 23.0mn
52wk high/low	Rs 334/Rs 163
Promoter/FPI/DII	51%/19%/30%

Source: NSE

Marketing business earnings normalise: Earnings from the marketing business matched estimates at Rs 20.3bn. Though down 61% QoQ, this was to be expected as margins normalised. HPCL's dependence on marketing business EBITDA surged to >60% in Q1FY20, raising the risk profile of earnings as this business is sensitive to political intervention (IOCL being the least sensitive among OMCs).

STOCK PERFORMANCE



Source: NSE

Maintain SELL: At 5x FY21E EPS, HPCL's valuations may seem undemanding, but high reliance on marketing segment earnings remains a major concern in a politically sensitive climate and could negate gains from the recent decline in oil prices. GRM underperformance amid the global slowdown also remains a key risk to earnings.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	72,183	66,900	59,176	61,882	74,128
Adj. EPS (Rs)	47.4	43.9	38.8	40.6	48.6
Adj. EPS growth (%)	(12.4)	(7.3)	(11.5)	4.6	19.8
Adj. ROAE (%)	31.0	23.9	18.5	17.6	19.1
Adj. P/E (x)	5.2	5.6	6.3	6.0	5.0
EV/EBITDA (x)	6.0	5.6	8.4	9.1	8.1

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Net sales	7,07,105	6,73,315	5.0	6,76,286	4.6
Purchases	5,11,618	4,56,750	12.0	4,62,742	10.6
% of sales	72.4	67.8	-	68.4	-
Other expenditure	1,81,832	1,87,633	(3.1)	1,64,977	10.2
% of sales	25.7	27.9	-	24.4	-
EBITDA	13,655	28,933	(52.8)	48,567	(71.9)
EBITDA margin (%)	1.9	4.3	-	7.2	-
Depreciation and amortisation	8,151	7,064	15.4	8,285	(1.6)
Interest	2,063	1,909	8.1	1,872	10.2
Other income	8,949	6,029	48.4	8,320	7.6
PBT	12,390	25,990	(52.3)	46,731	(73.5)
Provision for tax	4,281	8,798	(51.3)	17,032	(74.9)
Adj. PAT	8,110	17,192	(52.8)	29,699	(72.7)
Other comprehensive income	-	(151)	-	-	-
Total income	8,110	17,041	(52.4)	29,699	(72.7)
NPM (%)	1.1	2.6	-	4.4	-
Adj. EPS (Rs)	5.3	11.3	(52.8)	19.5	(72.7)
Reported GRMs (US\$/bbl)	0.75	7.2	(89.5)	4.5	(83.4)
Refining throughput (mmt)	3.9	4.5	(13.3)	4.6	(14.8)
Market sales (mmt)	10.1	9.7	3.8	10.1	(0.2)
Pipeline throughput (mmt)	5.3	5.5	(2.0)	5.6	(4.8)

Source: Company, BOBCAPS Research

FIG 2 – PETROLEUM PRODUCT SALES VOLUME

(mmt)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Domestic					
MS	1.89	1.74	8.6	1.78	6.2
HSD	4.90	4.82	1.7	4.62	6.1
SKO	0.13	0.14	(7.1)	0.14	(7.1)
LPG	1.49	1.52	(2.0)	1.80	(17.2)
Aviation	0.18	0.21	(14.3)	0.23	(21.7)
Others	0.26	0.24	8.3	0.25	4.0
Total Domestic	9.82	9.64	1.9	10.04	(2.2)
Export	0.27	0.08	237.5	0.08	237.5
Total Sales	10.09	9.72	3.8	10.12	(0.3)

Source: Company, BOBCAPS Research

FIG 3 – SEGMENT-WISE PERFORMANCE

	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Crude throughput (mmt)	3.92	4.52	(13.3)	4.60	(14.8)
GRM (US\$/bbl)	0.75	7.15	(89.5)	4.53	(83.4)
Normalised GRMs (US\$/bbl)	3.33	3.23	3.2	2.12	56.9
Refining EBITDA (Rs mn)	(4,040)	7,570	(153.4)	6,500	(162.2)
Refining EBITDA (US\$/bbl)	(2.0)	3.4	(159.3)	2.7	(173.9)
Inventory gains/ (loss) (Rs mn)	(5,160)	8,710	(159.2)	5,720	(190.2)
Inventory gains/ (loss) (US\$/bbl)	(2.6)	3.9	-	2.4	-
Exchange fluctuation gain/(loss) (Rs mn)	880	(1,830)	-	1,000	-
Adjusted Refining EBITDA (Rs mn)	240	690	(65.2)	(220)	(209.1)
Adjusted Refining EBITDA (US\$/bbl)	0.12	0.31	(61.4)	(0.09)	-
Market sales (mmt)	10.09	9.72	3.8	10.11	(0.2)
Domestic sales	9.82	9.64	1.9	10.03	(2.1)
Exports	0.27	0.08	237.5	0.08	237.5
Marketing EBITDA (Rs mn)	20,340	27,780	(26.8)	52,270	(61.1)
Marketing EBITDA (Rs/mt)	2,016	2,858	(29.5)	5,170	(61.0)
Inventory gains/ (loss) (Rs mn)	(200)	14,600	(101.4)	3,440	(105.8)
Inventory gains/ (loss) (Rs/mt)	(20)	1,502	-	340	-
Exchange fluctuation gain/(loss) (Rs mn)	1,060	(3,550)	-	1,480	28.4
Adj. Marketing EBITDA (Rs mn)	19,480	16,730	16.4	47,350	(58.9)
Adj. Marketing EBITDA (Rs/mt)	1,931	1,721	12.2	4,683	(58.8)
Others EBITDA (Rs mn)	6,300	(390)	-	(1,880)	-
Reported EBITDA (Rs mn)	13,655	28,933	(52.8)	48,567	(71.9)

Source: Company, BOBCAPS Research

Valuation methodology

We trim FY20 earnings estimates by 3.7% on lower GRM assumptions. We also introduce FY22 forecasts, baking in earnings growth at 18% largely spurred by volumes (refining capacity additions at Vizag).

At 5x FY21E EPS, HPCL's valuations may seem undemanding, but high reliance on marketing segment earnings remains a major concern in a politically sensitive environment and could negate gains from the recent decline in oil prices. GRM underperformance amid the global slowdown also remains a key risk to earnings. We note that a challenging macro climate for cyclicals exposes less efficient refiners to earnings shocks.

We maintain SELL and roll forward to a Jun'20 SOTP-based target price of Rs 200 (from Rs 210), which is arrived at as follows:

- Refining business for the standalone refinery and Bhatinda refinery valued at 6.5x Sep'21E EBITDA each, and
- Nil valuation retained for the marketing business on rising concerns over marketing margin regulations (which could potentially lead to under-recovery on deregulated products if oil prices were to surge).

FIG 4 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	3,088,090	2,738,792	(11.3)	3,712,642	3,308,413	(10.9)	3,723,064
EBITDA	88,703	74,920	(15.5)	91,884	80,938	(11.9)	99,038
EBITDA margin (%)	2.9	2.7	-	2.5	2.4	-	2.7
PAT	61,467	59,176	(3.7)	62,391	61,882	(0.8)	72,960
EPS (Rs)	40.3	38.8	(3.7)	40.9	40.6	(0.8)	47.9

Source: BOBCAPS Research

FIG 5 – SOTP VALUATION SUMMARY

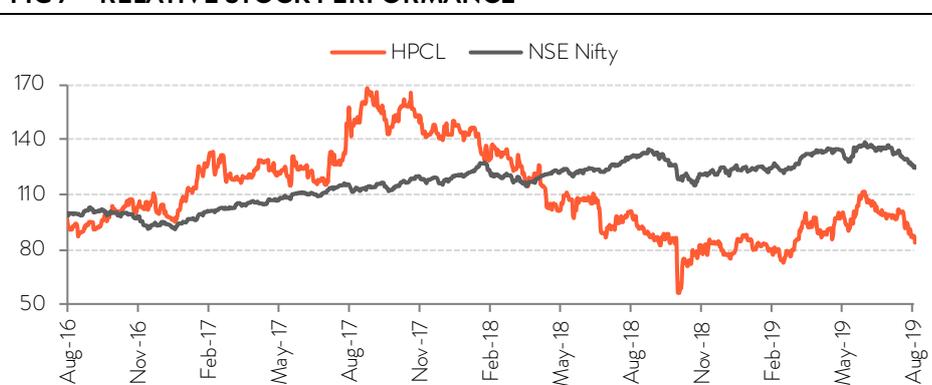
	EV (Rs bn)	Value (Rs/sh)	Comments
Refining Business	280	184	6.5x Sep'21E EBITDA
Marketing & others	-	-	-
Bhatinda refinery	169	111	6.5x Sep'21E EBITDA
Total core business	449	295	-
Less: Net debt	165	108	Adjusted for Bhatinda stake
Equity Value of core businesses	285	187	-
MRPL stake	12	8	20% discount to CMP
OIL stake	5	4	20% discount to CMP
HPCL's Equity Value (Rs)	300	200	0.8x FY21E Book Value

Source: BOBCAPS Research

FIG 6 – KEY ASSUMPTIONS

	FY20E	FY21E	FY22E
USDINR (Rs)	72.0	74.0	74.0
Crude price (US\$/bbl)	65.0	70.0	70.0
Mumbai & Vizag refineries			
GRM (US\$/bbl)	5.0	6.0	6.0
Crude throughput (mmt)	20.3	24.4	24.4
HMEL (Bhatinda)			
GRM (US\$/bbl)	14.0	14.0	14.0
Crude throughput (mmt)	12.5	12.5	12.5
Total market sales (mmt)	40.0	42.7	45.2

Source: BOBCAPS Research

FIG 7 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

- **Global growth:** HPCL's valuations are highly sensitive to GRMs and marketing margins. An acceleration in global economies (and consequently the Indian economy) could lead to above-expected spreads and alter our valuation outlook.
- **Crash in oil prices:** A crash in oil prices (to <US\$ 50/bbl levels) could spur a change in government regulation on marketing margins for retail sales of petrol/diesel – in turn driving upsides to our earnings and valuation outlook.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	2,186,469	2,742,552	2,802,970	3,404,472	3,819,124
EBITDA	98,502	103,490	74,920	80,938	99,038
EBIT	70,158	72,637	51,089	55,873	72,741
Net interest income/(expenses)	(6,179)	(7,856)	(13,727)	(21,783)	(29,883)
Other income/(expenses)	23,906	26,315	31,323	37,650	48,587
EBT	87,885	91,095	68,684	71,741	91,445
Income taxes	(28,919)	(33,486)	(24,708)	(25,480)	(32,938)
Min. int./Inc. from associates	(13,216)	(9,291)	(15,199)	(15,622)	(15,622)
Reported net profit	72,183	66,900	59,176	61,882	74,128
Adjusted net profit	72,183	66,900	59,176	61,882	74,128

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	158,459	190,534	172,271	215,102	241,806
Other current liabilities	46,701	45,261	61,017	74,336	83,205
Provisions	24,496	23,951	23,951	23,951	23,951
Debt funds	219,520	260,365	385,974	444,193	512,411
Other liabilities	192,218	250,108	253,638	255,955	258,949
Equity capital	15,242	15,242	15,242	15,242	15,242
Reserves & surplus	240,082	288,765	319,407	352,756	393,001
Shareholders' fund	255,324	304,007	334,649	367,998	408,243
Total liabilities and equities	896,718	1,074,226	1,231,500	1,381,534	1,528,565
Cash and cash eq.	13,052	2,185	23,526	18,858	26,064
Accounts receivables	55,870	56,674	60,028	72,513	81,601
Inventories	186,122	204,436	323,870	387,183	435,251
Other current assets	85,762	133,591	133,591	133,591	133,591
Investments	128,820	142,975	172,975	202,975	237,974
Net fixed assets	387,035	439,011	442,579	444,914	446,017
CWIP	39,890	95,187	74,765	121,332	167,900
Intangible assets	167	167	167	167	167
Total assets	896,718	1,074,226	1,231,500	1,381,533	1,528,565

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	99,866	97,549	83,007	86,947	100,426
Changes in working capital	19,558	21,035	(121,765)	(17,332)	(18,588)
Other operating cash flows	(23,906)	(26,315)	(31,323)	(37,650)	(48,587)
Cash flow from operations	95,519	92,269	(70,081)	31,965	33,251
Capital expenditures	(67,298)	(138,126)	(6,977)	(73,968)	(73,968)
Change in investments	(12,179)	(13,311)	(3,000)	(3,000)	(3,000)
Other investing cash flows	24,999	25,471	4,323	10,650	16,587
Cash flow from investing	(54,478)	(125,966)	(5,654)	(66,318)	(60,380)
Equities issued/Others	5,079	0	0	0	0
Debt raised/repaid	(1,781)	40,845	125,609	58,219	68,219
Dividends paid	(30,317)	(28,355)	(28,533)	(28,533)	(33,883)
Other financing cash flows	(2,336)	10,340	0	0	0
Cash flow from financing	(29,354)	22,830	97,076	29,685	34,335
Changes in cash and cash eq.	11,687	(10,867)	21,341	(4,668)	7,206
Closing cash and cash eq.	13,051	2,185	23,526	18,858	26,064

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	47.4	43.9	38.8	40.6	48.6
Adjusted EPS	47.4	43.9	38.8	40.6	48.6
Dividend per share	17.0	15.9	16.0	16.0	19.0
Book value per share	167.5	199.5	219.6	241.4	267.8

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	0.3	0.2	0.2	0.2	0.2
EV/EBITDA	6.0	5.6	8.4	9.1	8.1
Adjusted P/E	5.2	5.6	6.3	6.0	5.0
P/BV	1.5	1.2	1.1	1.0	0.9

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	82.1	73.4	86.2	86.3	81.1
Interest burden (PBT/EBIT)	125.3	125.4	134.4	128.4	125.7
EBIT margin (EBIT/Revenue)	3.2	2.6	1.8	1.6	1.9
Asset turnover (Revenue/Avg TA)	257.2	278.3	243.1	260.6	262.5
Leverage (Avg TA/Avg Equity)	3.6	3.5	3.6	3.7	3.7
Adjusted ROAE	31.0	23.9	18.5	17.6	19.1

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

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	16.9	25.4	2.2	21.5	12.2
EBITDA	(6.1)	5.1	(27.6)	8.0	22.4
Adjusted EPS	(12.4)	(7.3)	(11.5)	4.6	19.8
Profitability & Return ratios (%)					
EBITDA margin	4.5	3.8	2.7	2.4	2.6
EBIT margin	3.2	2.6	1.8	1.6	1.9
Adjusted profit margin	3.3	2.4	2.1	1.8	1.9
Adjusted ROAE	31.0	23.9	18.5	17.6	19.1
ROCE	10.4	8.8	5.1	4.7	5.4
Working capital days (days)					
Receivables	8	7	8	7	7
Inventory	132	105	139	140	139
Payables	25	24	24	21	22
Ratios (x)					
Gross asset turnover	3.3	3.8	3.6	4.2	4.5
Current ratio	1.0	1.0	1.0	1.0	1.0
Net interest coverage ratio	11.4	9.2	3.7	2.6	2.4
Adjusted debt/equity	0.8	0.8	1.1	1.2	1.2

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

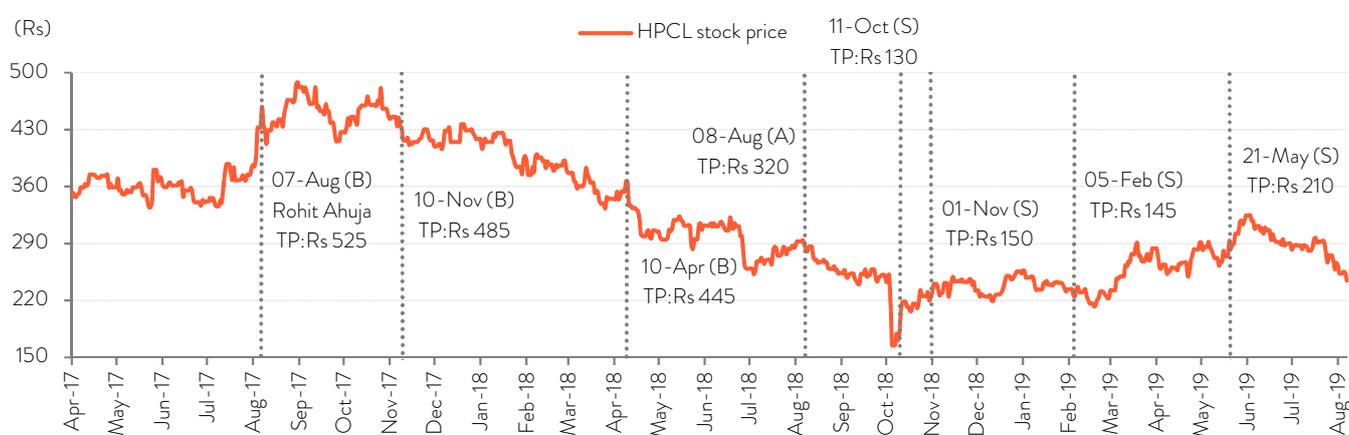
ADD – Expected return from >+5% to +15%

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)

HISTORICAL RATINGS AND TARGET PRICE: HINDUSTAN PETROLEUM CORP (HPCL IN)



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

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