

BUY

TP: Rs 480 | ▲ 16%

**BHARAT PETROLEUM
CORP**

| Oil & Gas

| 14 August 2020

GRMs outperform but marketing to aid earnings growth

BPCL's Q1FY21 earnings beat estimates driven by higher GRMs (US\$ 1.9/bbl) and a surge in marketing margins. EBITDA outperformed at Rs 39bn (+80% YoY), clearly driven by the marketing segment while refining losses continued. Given that benchmark GRMs remain muted, BPCL's marketing segment provides strong hope for sustenance of earnings and ROE (>20% levels). We adjust FY21/FY22 earnings by +10%/–9% as we lower GRM and raise marketing margin estimates. Our TP changes to Rs 480 (from Rs 470) on rollover.

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GRMs outperform: BPCL's GRMs came in ahead of expectations at US\$ 1.9/bbl (ex-inventory loss of US\$ 1.5/bbl), beating the Singapore benchmark. Kochi GRMs outperformed the company average at US\$ 2.8/bbl (ex-inventory loss) as its distillate yield improved. The GRM outlook remains muted considering sustained oil demand concerns amid the pandemic. We cut FY21/FY22 GRM estimates to US\$ 1.5/US\$ 2.5 (from US\$ 4/US\$ 4.5).

Marketing segment earnings surge: Q1 marketing business earnings (implied from GRM data) surged to Rs 45bn (Rs 5,433/mt). Sale volumes were better than estimates at 7.5mmt (–32% YoY), though diesel and other industrial products suffered market share losses. Marketing margins may remain robust as this segment offers strategic earnings growth potential in a muted GRM scenario. We raise marketing margin estimates for FY21/FY22 to ~Rs 2,900/mt (from Rs 1,900 earlier).

Divestment could drive valuations: At 9.7x 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.

Ticker/Price	BPCL IN/Rs 413
Market cap	US\$ 10.9bn
Shares o/s	1,967mn
3M ADV	US\$ 59.3mn
52wk high/low	Rs 549/Rs 252
Promoter/FPI/DII	53%/12%/35%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	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)	9.5	23.3	8.3	9.6	9.0
EV/EBITDA (x)	7.7	14.5	8.6	9.6	8.5

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
Net sales	387,851	763,179	(49.2)	689,914	(43.8)
EBITDA	39,158	21,799	79.6	(6,188)	-
EBITDA margin (%)	10.1	2.9	253.5	(0.9)	-
Depreciation and amortisation	9,959	9,141	8.9	9,474	5.1
Interest	5,871	4,524	29.8	5,786	1.5
Other income	5,933	5,385	10.2	11,568	(48.7)
PBT	29,262	13,518	116.5	(9,880)	-
Provision for tax	8,500	2,767	207.2	(7,079)	-
Effective tax rate	29.05	20.47	-	71.64	-
PAT (reported)	20,762	10,751	93.1	(2,802)	-
PAT (adjusted)	20,762	10,751	93.1	(2,802)	-
EPS (adj.)	10.56	5.47	93.1	(1.42)	-
Reported GRMs (US\$/bbl)	0.39	2.81	(86.1)	0.75	(48.0)
Refining throughput (mmt)	5.14	7.45	(31.0)	8.39	(38.7)
Market sales (mmt)	8.32	11.34	(26.6)	11.24	(26.0)

Source: Company, BOBCAPS Research

FIG 2 – OPERATIONAL PERFORMANCE

	Q1FY21	Q1FY20	YoY (%)	Q4FY20	QoQ (%)
GRM (US\$/bbl)	0.39	2.81	(86.1)	0.8	(48.0)
- Mumbai	0.31	3.49	(91.1)	1.0	(68.0)
- Kochi	0.49	2.33	(79.0)	0.5	(9.3)
Inventory gains/ (loss) (US\$/bbl)	(1.53)	(0.86)	78.9	(6.52)	(76.5)
Normalised GRMs (US\$/bbl)	1.92	3.67	(47.6)	7.27	(73.6)
- Mumbai	(0.52)	3.57	(114.6)	1.0	(153.6)
- Kochi	2.80	3.76	(25.5)	0.5	418.5
Crude throughput (MMT)	5.14	7.45	(31.0)	8.4	(38.7)
Adj. Refining EBITDA (Rs mn)	(1,662)	4,428	(137.5)	21,686	(107.7)
Total market sales (MT)	8.32	11.34	(26.6)	11.24	(26.0)
Market sales (MT) - Domestic	7.5	11.1	(32.2)	10.7	(29.8)
Market sales (MT) - Exports	0.79	0.23	243.5	0.51	54.9
Marketing EBITDA (Rs mn)	45,200	20,620	119.2	1,776	2,445.4
Marketing EBITDA (Rs/MT)	5,433	1,818	198.8	158	3,338.7
Marketing inventory gains/(loss) (Rs mn)	10,030	(1,270)	-	(19,370)	-
Adj Marketing EBITDA (Rs mn)	35,170	21,890	60.7	21,146	66.3
Adj Marketing EBITDA (Rs/MT)	4,227	1,930	119.0	1,881	124.7
Total reported EBITDA (Rs mn)	39,158	21,799	79.6	(6,188)	(732.8)

Source: Company, BOBCAPS Research

FIG 3 – INDUSTRY VS. BPCL

Petroleum product sales volume (TMT)	BPCL QoQ growth (%)	Industry QoQ growth (%)	BPCL YoY growth (%)	Industry YoY growth (%)
LPG	(8.2)	(5.0)	10.6	13.3
MS	(33.2)	(29.5)	(38.7)	(35.9)
HSD	(26.6)	(23.8)	(35.7)	(33.3)
SKO	(12.5)	(5.8)	(46.2)	(39.7)
ATF	(81.6)	(79.7)	(82.4)	(80.7)
Others	(44.1)	2.3	(35.8)	(11.7)
Total domestic sales	(29.8)	(22.5)	(32.2)	(24.5)

Source: Company, BOBCAPS Research

Earnings call highlights

- Q1FY21 GRM was at US\$ 25/bbl (after tax benefits) for the Numaligarh refinery and US\$ 3/bbl for the Bharat Oman Refineries (BORL) plant.
- Kochi refinery has the flexibility to process all types of crude and had an inventory gain in Q1 while Mumbai refinery had an inventory loss. This is unusual – inventory gain/loss depends on the kind of inventory accounted for and the type of crude processed by the refinery.
- Dues from the government for unpaid subsidies totalled Rs 42bn at the end of June (vs. Rs 52bn at end-March).
- BPCL's ATF sales dropped to near-zero levels in Q1 as it mainly sells in the international market where flights had been halted.
- Product inventory for MS and HSD was 2mmt and total product inventory stood at 3mmt at the end of Q1.
- BPCL currently has 16,492 outlets and plans to continue adding ~1,000 outlets every year. Of these, 531 sell CNG.
- The company has converted its convertible debentures into equity for its JV with BORL, raising its equity stake to 62%. Despite high equity ownership, BORL is considered a JV as the pre-shareholder agreement is still in place.
- Project finance agreements for Mozambique have already been signed and the project is expected to commence within the next four years. Covid-19 did lead to some operational difficulties during the quarter.

Valuation methodology

Given that benchmark GRMs remain muted, BPCL's marketing segment provides strong hope for sustenance of earnings and ROE (>20% levels). We adjust FY21/FY22 earnings by +10%/-9% as we lower GRM and raise marketing margin estimates. On rolling valuations over, we arrive at a revised Sep'21 target price of Rs 480 (from Rs 470).

At 9.7x 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.

FIG 4 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E
	Old	New	Var (%)	Old	New	Var (%)	New
Revenue	3,735,442	2,063,899	(44.7)	3,974,070	2,542,468	(36.0)	3,140,495
EBITDA	141,962	155,003	9.2	157,886	151,260	(4.2)	177,846
EBITDA margin (%)	6.6	7.5	-	6.0	5.9	-	5.7
PAT	88,533	97,490	10.1	92,917	84,612	(8.9)	90,449
EPS (Rs)	45.0	49.6	10.1	47.2	43.0	(8.9)	46.0

Source: Company, BOBCAPS Research

Our SOTP valuation is arrived at as follows:

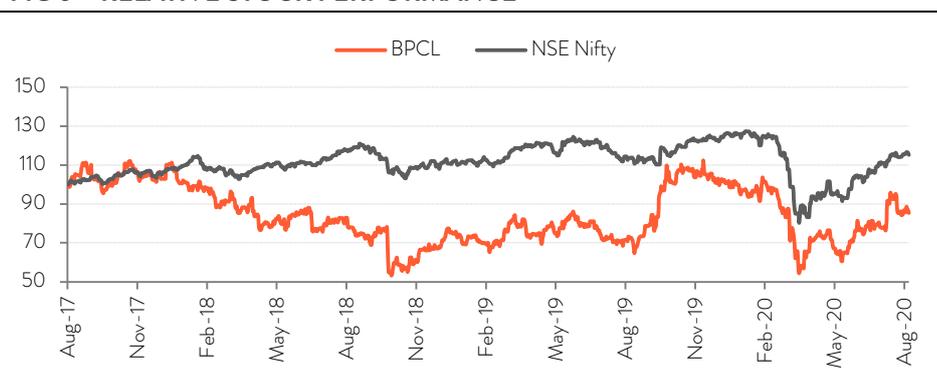
- refining businesses valued at 6x Sep'22E EBITDA,
- marketing business at 5x Sep'22E EBITDA,
- other investments in listed entities valued at 20% discount to CMP, and
- E&P business valued at an EV/boe of US\$ 1 and US\$ 4/boe for yet-to-be developed reserves in Mozambique and Brazil respectively. Note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

FIG 5 – 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 6 – 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	FY20P	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	FY20P	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	FY20P	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	FY20P	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	FY20P	FY21E	FY22E	FY23E
EV/Sales	0.4	0.4	0.6	0.6	0.5
EV/EBITDA	7.7	14.5	8.6	9.6	8.5
Adjusted P/E	9.5	23.3	8.3	9.6	9.0
P/BV	1.9	2.2	1.9	1.7	1.6

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20P	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	FY20P	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%

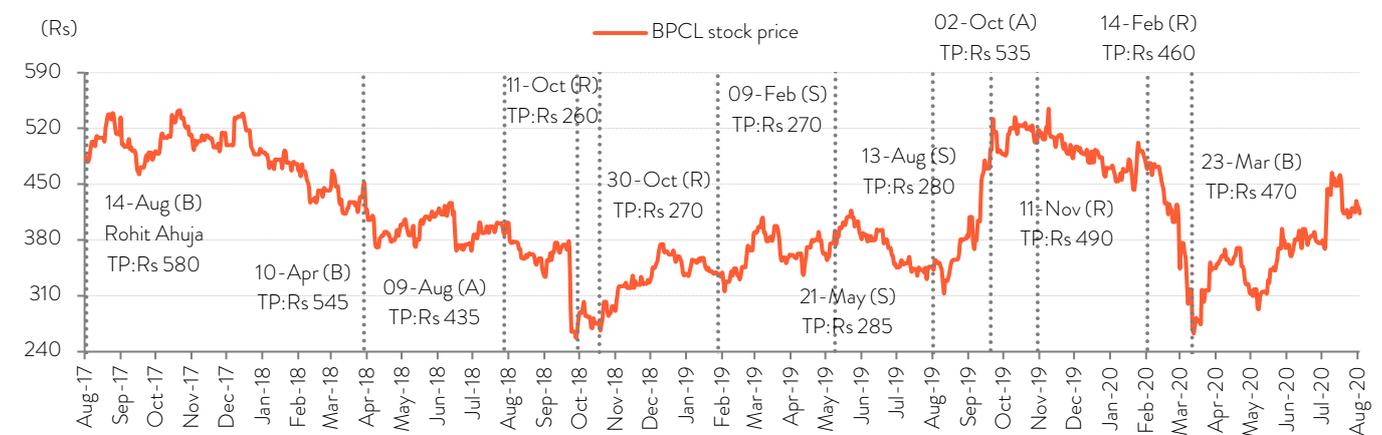
ADD – Expected return from >+5% to +15%

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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