

**BUY**

TP: Rs 440 | ▲ 114%

**HINDUSTAN  
PETROLEUM CORP**

Oil & Gas

05 November 2020

## GRMs recover, marketing margins remain elevated

HPCL's Q2FY21 earnings remained robust at Rs 24.7bn (+2.4x YoY). Q2 highlights: (a) GRMs outperformed at US\$ 5.1/bbl (incl. US\$ 2.4/bbl inventory gains), (b) indicative marketing EBITDA at Rs 3,253/mt (+21% YoY) was below estimates, while sales volume recovered slightly to 8.43mmt (-10% YoY). H2FY21 looks better for marketing volumes even as low oil prices provide flexibility to sustain high marketing margins, making earnings countercyclical. We maintain our Sep'21 TP of Rs 440.

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**Marketing margins make earnings countercyclical:** HPCL's marketing margins normalised to Rs 3,253/mt (still up 21% YoY). Management sounded optimistic on volume growth recovery in H2FY21 as India emerges from the pandemic induced lockdown. Oct'20 has seen YoY growth in petrol and diesel consumption. Unlike private peers, the large dependence of HPCL – and OMCs in general – on domestic markets (with a dominant >80% market share) gives them a massive advantage. With oil prices sustaining at lower levels, OMC marketing margins are expected to remain elevated, enabling them to make up for low GRMs.

Ticker/Price	HPCL IN/Rs 205
Market cap	US\$ 4.2bn
Shares o/s	1,524mn
3M ADV	US\$ 21.2mn
52wk high/low	Rs 317/Rs 150
Promoter/FPI/DII	51%/15%/33%

Source: NSE

**GRMs outperform:** HPCL outperformed its OMC peers to report one of the best core GRMs (ex-inventory) at US\$ 2.75/bbl. Oct'20 looks better for margins, as the Singapore benchmark has turned positive. HPCL's relatively high exposure to light-distillate product output (petrol, lubricants) aided the margin beat.

## STOCK PERFORMANCE



Source: NSE

**Valuations undemanding:** Management announced a very optimistic buyback offer for 6.5% equity, at a price upto Rs 250/sh (34% premium to the closing price of 4 November). With valuations at 3.5x FY22E EV/EBITDA and ROE at >30%, a buyback is clearly the most attractive proposition. Management has ruled out any dilution in dividend payouts. We reiterate our view that risk-reward in HPCL remains at one of the historical best levels. BUY.

## KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	2,742,552	2,679,238	1,917,613	2,472,832	3,217,817
EBITDA (Rs mn)	102,919	44,947	149,138	152,040	172,015
Adj. net profit (Rs mn)	48,312	45,580	73,969	85,588	103,306
Adj. EPS (Rs)	31.7	29.9	48.5	56.2	67.8
Adj. EPS growth (%)	(33.1)	(5.7)	62.3	15.7	20.7
Adj. ROAE (%)	17.3	14.9	23.1	24.8	27.6
Adj. P/E (x)	6.5	6.9	4.2	3.7	3.0
EV/EBITDA (x)	3.9	9.1	3.3	3.8	3.5

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

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 (%)
<b>Net sales</b>	<b>515,111</b>	<b>605,728</b>	<b>(15.0)</b>	<b>374,982</b>	<b>37.4</b>	<b>890,093</b>	<b>1,312,833</b>	<b>(32.2)</b>
Purchases	360,679	407,228	(11.4)	228,980	57.5	589,659	918,957	(35.8)
% of sales	70.0	67.2	-	61.1	-	66.2	70.0	-
Other expenditure	121,015	178,216	(32.1)	104,692	15.6	225,707	359,936	(37.3)
% of sales	23.5	29.4	-	27.9	-	25.4	27.4	-
<b>EBITDA</b>	<b>33,417</b>	<b>20,284</b>	<b>64.7</b>	<b>41,310</b>	<b>(19.1)</b>	<b>74,727</b>	<b>33,939</b>	<b>120.2</b>
<b>EBITDA margin (%)</b>	<b>6.5</b>	<b>3.3</b>	<b>-</b>	<b>11.0</b>	<b>-</b>	<b>8.4</b>	<b>2.6</b>	<b>-</b>
Depreciation and amortisation	8,683	8,121	6.9	8,661	0.2	17,344	16,272	6.6
Interest	2,604	2,856	(8.8)	3,217	(19.1)	5,821	4,919	18.3
Other income	10,790	6,863	57.2	7,852	37.4	18,642	15,811	17.9
<b>PBT</b>	<b>32,920</b>	<b>16,170</b>	<b>103.6</b>	<b>37,284</b>	<b>(11.7)</b>	<b>70,204</b>	<b>28,560</b>	<b>145.8</b>
Exceptional item	-	-	-	-	-	-	-	-
Provision for tax	8,146	5,647	44.3	9,146	(10.9)	17,291	9,928	74.2
<b>PAT (reported)</b>	<b>24,775</b>	<b>10,523</b>	<b>135.4</b>	<b>28,138</b>	<b>(12.0)</b>	<b>52,913</b>	<b>18,633</b>	<b>184.0</b>
Other comprehensive income	(221)	-	-	(44)	-	(265)	7,617	-
<b>Total income</b>	<b>24,553</b>	<b>10,523</b>	<b>133.3</b>	<b>28,094</b>	<b>(12.6)</b>	<b>52,647</b>	<b>26,249</b>	<b>100.6</b>
<b>NPM (%)</b>	<b>4.8</b>	<b>1.7</b>	<b>-</b>	<b>7.5</b>	<b>-</b>	<b>5.9</b>	<b>1.4</b>	<b>-</b>
<b>EPS (reported) (Rs)</b>	<b>16.1</b>	<b>6.9</b>	<b>133.3</b>	<b>18.4</b>	<b>(12.6)</b>	<b>34.5</b>	<b>17.2</b>	<b>100.5</b>
<b>Pipeline throughput (mmt)</b>	<b>4.7</b>	<b>5.1</b>	<b>(6.9)</b>	<b>3.5</b>	<b>32.8</b>	<b>8.2</b>	<b>10.4</b>	<b>(20.7)</b>

Source: Company, BOBCAPS Research

**FIG 2 – SEGMENT-WISE PERFORMANCE**

	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
<b>Crude throughput (mmt)</b>	<b>4.06</b>	<b>4.56</b>	<b>(11.0)</b>	<b>3.97</b>	<b>2.3</b>	<b>8.03</b>	<b>8.48</b>	<b>(5.3)</b>
<b>GRM (US\$/bbl)</b>	<b>5.11</b>	<b>2.83</b>	<b>80.4</b>	<b>0.04</b>	<b>12,675.0</b>	<b>2.58</b>	<b>1.87</b>	<b>38.0</b>
<b>Normalised GRMs (US\$/bbl)</b>	<b>2.75</b>	<b>2.55</b>	<b>7.6</b>	<b>(0.87)</b>	<b>(416.2)</b>	<b>0.94</b>	<b>4.17</b>	<b>(77.4)</b>
<b>Refining EBITDA (Rs mn)</b>	<b>5,998</b>	<b>1,140</b>	<b>426.1</b>	<b>(5,219)</b>	<b>(214.9)</b>	<b>778</b>	<b>37,130</b>	<b>-</b>
<b>Refining EBITDA (US\$/bbl)</b>	<b>2.7</b>	<b>0.5</b>	<b>472.1</b>	<b>(2.4)</b>	<b>(214.8)</b>	<b>0.2</b>	<b>8.4</b>	<b>-</b>
Inventory gains/ (loss) (Rs mn)	5,230	660	692.4	2,010	160.2	7,240	(4,500)	-
Inventory gains/ (loss) (US\$/bbl)	2.36	0.28	743.9	0.91	160.0	1.64	(2.30)	-
Exchange fluctuation gain/(loss) (Rs mn)	79	(220)	-	280	71.8	359	660	-
<b>Adjusted Refining EBITDA (Rs mn)</b>	<b>689</b>	<b>700</b>	<b>(1.6)</b>	<b>(7,509)</b>	<b>(109.2)</b>	<b>(6,821)</b>	<b>40,970</b>	<b>(116.6)</b>
<b>Adjusted Refining EBITDA (US\$/bbl)</b>	<b>0.31</b>	<b>0.29</b>	<b>7.0</b>	<b>(3.40)</b>	<b>(109.2)</b>	<b>(1.54)</b>	<b>9.31</b>	<b>(116.6)</b>
<b>Market sales (mmt):</b>	<b>8.43</b>	<b>9.40</b>	<b>(10.3)</b>	<b>7.62</b>	<b>10.6</b>	<b>16.05</b>	<b>19.49</b>	<b>(17.7)</b>
Domestic sales	8.10	8.95	(9.5)	7.24	11.9	15.34	18.77	(18.3)
Exports	0.33	0.45	(26.7)	0.38	(13.2)	0.71	0.72	(1.4)
<b>Marketing EBITDA (Rs mn)</b>	<b>27,419</b>	<b>25,290</b>	<b>8.4</b>	<b>46,529</b>	<b>(41.1)</b>	<b>73,948</b>	<b>45,630</b>	<b>62.1</b>
<b>Marketing EBITDA (Rs/MT)</b>	<b>3,253</b>	<b>2,690</b>	<b>20.9</b>	<b>6,106</b>	<b>(46.7)</b>	<b>4,679</b>	<b>2,353</b>	<b>98.9</b>
Inventory gains/ (loss) (Rs mn)	12,570	(130)	-	4,320	191.0	16,890	(330)	-
Inventory gains/ (loss) (Rs/MT)	1,491	(14)	-	567	163.0	1,029	(17)	-
Exchange fluctuation gain/(loss) (Rs mn)	445	(1,000)	-	210	111.9	655	60	-
<b>Adj. Marketing EBITDA (Rs mn)</b>	<b>14,404</b>	<b>26,420</b>	<b>(45.5)</b>	<b>41,999</b>	<b>(65.7)</b>	<b>56,403</b>	<b>45,900</b>	<b>22.9</b>
<b>Adj. Marketing EBITDA (Rs/MT)</b>	<b>1,709</b>	<b>2,811</b>	<b>(39.2)</b>	<b>5,512</b>	<b>(69.0)</b>	<b>3,610</b>	<b>2,355</b>	<b>53.3</b>
<b>Others EBITDA (Rs mn)</b>	<b>na</b>	<b>720</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>18,000</b>	<b>-</b>	<b>-</b>
<b>Reported EBITDA (Rs mn)</b>	<b>33,417</b>	<b>20,284</b>	<b>64.7</b>	<b>41,310</b>	<b>-</b>	<b>74,727</b>	<b>33,939</b>	<b>120.2</b>

Source: Company, BOBCAPS Research

## Earnings call highlights

- Since Oct'20, marketing volumes have started to improve YoY with diesel resuming its growth trajectory and rising 11%. Positive growth in diesel is a sign of revival in the industrial economy.
- Even during the lockdown period, HPCL ran its refineries at close to 100% capacity utilisation. This decision was made as the company's product sales (40mmt p.a.) exceed its production at refineries (~29mmt incl. JVs).
- HPCL aims to create an end-to-end value chain for its CNG segment. It currently has 575 CNG stations in 20 geographical areas (GAs), besides 11 LNG dispensing stations. Management sees an opportunity in the use of LNG as a transportation fuel in the medium term.
- Petrochemicals are expected to form a substantial part of the company's production and marketing in the near term. About 6-6.4mmt of petchem production is set to come up after two plants get commissioned in the near term and other integration activities take place.
- GRMs remain subdued for H1FY21 but are expected to improve in the coming quarters. Management also indicated that shutting down of refineries in Europe may have a positive impact in the near term.
- On the capex front, the Mumbai refinery expansion has completed 80% of financial progress and 90-95% of physical progress. Vizag refinery expansion has completed 70% of the physical progress and 50% of financial progress.
- HPCL currently has ~Rs 40bn outstanding from the government for subsidy payments.
- As the current buyback is less than 10% of the total equity and reserves, HPCL does not require shareholder approval. Since this is an OMO, the promoter (ONGC) will not be participating in the buyback.

## Valuation methodology

Management has announced a very optimistic buyback offer for 6.5% equity, at a price upto Rs 250/sh (34% premium to the closing price of 4 November). With valuations at 3.5x FY22E EV/EBITDA and ROE at >30%, a buyback is clearly a most attractive proposition. Management has ruled out any dilution in dividend payouts. We reiterate our view that risk-reward in HPCL remains at one of the historical best levels. Maintain BUY with a Sep'21 SOTP-based target price of Rs 440.

Valuation multiples for our SOTP model remain unchanged as follows:

- refining business valued at 6x Sep'22E EBITDA, and
- marketing business valued at 5x Sep'22E EBITDA.

**FIG 3 – SOTP VALUATION SUMMARY**

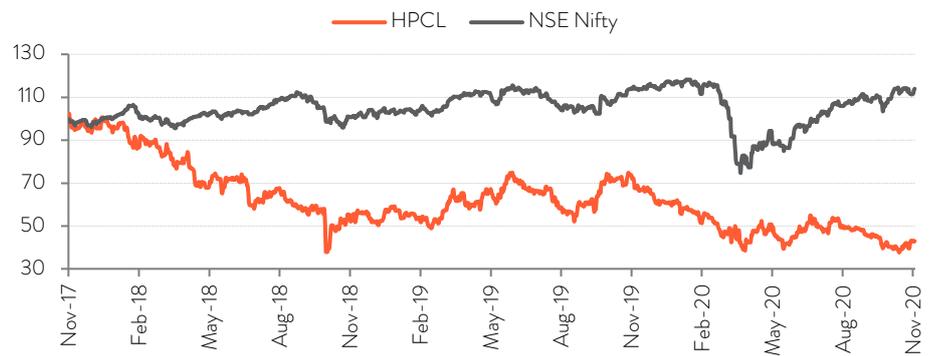
Business	EV (Rs bn)	Value (Rs/sh)	Comments
Refining Business	29	19	6x Sep'22E EBITDA
Marketing & others	786	516	5x Sep'22E EBITDA
Bhatinda refinery	-	-	Nil valuation on losses
<b>Total core business</b>	<b>815</b>	<b>535</b>	-
Less: Net debt	151	99	Adjusted for Bhatinda stake
<b>Equity Value of core businesses</b>	<b>661</b>	<b>434</b>	-
MRPL stake	6	3	20% discount to CMP
OIL stake	3	2	20% discount to CMP
<b>HPCL's Equity Value (Rs)</b>	<b>672</b>	<b>440</b>	<b>7.9x FY22E EPS</b>

Source: Company, BOBCAPS Research

**FIG 4 – KEY ASSUMPTIONS**

	FY21E	FY22E	FY23E
<b>USDINR (Rs)</b>	<b>76.0</b>	<b>78.0</b>	<b>80</b>
<b>Crude price (US\$/bbl)</b>	<b>35.0</b>	<b>40.0</b>	<b>45.0</b>
<b>Mumbai &amp; Vizag refineries</b>			
GRM (US\$/bbl)	2.0	3.0	3.5
Crude throughput (mmt)	24.4	28.5	28.5
<b>HMEL (Bhatinda)</b>			
GRM (US\$/bbl)	7.0	8.0	10.0
Crude throughput (mmt)	12.0	12.0	12.0
<b>Product sales (mmt)</b>	<b>40.7</b>	<b>43.4</b>	<b>46.4</b>

Source: BOBCAPS Research

**FIG 5 – RELATIVE STOCK PERFORMANCE**

Source: NSE

### Key risks

- **Extended global slowdown:** HPCL's valuations are highly sensitive to GRMs and marketing margins. An extended global economic slowdown due to the current pandemic may alter our valuation outlook and GRM/marketing margins assumptions.
- **Surge in oil prices:** Oil prices (>US\$ 70/bbl levels) could lead to concerns such as government control on marketing margins for retail sales of petrol and diesel.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Total revenue</b>	<b>2,742,552</b>	<b>2,679,238</b>	<b>1,917,613</b>	<b>2,472,832</b>	<b>3,217,817</b>
EBITDA	102,919	44,947	149,138	152,040	172,015
Depreciation	(30,853)	(33,699)	(29,734)	(33,217)	(36,700)
EBIT	72,066	11,248	119,404	118,823	135,315
Net interest income/(expenses)	(7,856)	(11,389)	(22,481)	(30,796)	(41,523)
Other income/(expenses)	26,885	28,494	20,367	40,831	49,185
Exceptional items	0	(10,029)	0	0	0
EBT	91,095	28,354	117,290	128,859	142,977
Income taxes	(33,486)	12,644	(31,288)	(35,037)	(39,671)
Min. int./Inc. from associates	9,297	(4,582)	12,033	8,233	0
<b>Reported net profit</b>	<b>48,312</b>	<b>35,551</b>	<b>73,969</b>	<b>85,588</b>	<b>103,306</b>
<b>Adjusted net profit</b>	<b>48,312</b>	<b>45,580</b>	<b>73,969</b>	<b>85,588</b>	<b>103,306</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	171,334	114,688	108,517	145,792	194,870
Other current liabilities	47,040	35,078	39,555	51,908	68,124
Provisions	21,406	26,852	26,852	26,852	26,852
Debt funds	260,365	393,858	462,916	522,916	622,916
Other liabilities	269,314	288,780	295,237	302,467	310,653
Equity capital	15,242	15,242	15,242	15,242	15,242
Reserves & surplus	288,765	294,564	316,682	342,834	374,319
Shareholders' fund	304,007	309,806	331,924	358,076	389,561
<b>Total liabilities and equities</b>	<b>1,073,465</b>	<b>1,169,062</b>	<b>1,265,000</b>	<b>1,408,010</b>	<b>1,612,976</b>
Cash and cash eq.	2,185	2,231	19,302	6,100	32,833
Accounts receivables	56,678	39,342	42,039	54,208	70,537
Inventories	204,436	193,260	195,331	262,426	350,767
Other current assets	155,507	128,957	128,957	128,957	128,957
Investments	142,975	143,956	173,956	208,956	243,956
Net fixed assets	416,330	489,452	537,118	581,302	622,002
CWIP	95,187	171,698	168,265	164,833	161,400
Intangible assets	167	167	167	167	167
<b>Total assets</b>	<b>1,073,465</b>	<b>1,169,062</b>	<b>1,265,135</b>	<b>1,406,948</b>	<b>1,610,618</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	97,759	60,086	103,703	118,805	140,005
Changes in working capital	(1,646)	11,367	(6)	(22,406)	(31,189)
Other operating cash flows	(26,885)	(18,465)	(20,367)	(40,831)	(49,185)
<b>Cash flow from operations</b>	<b>69,228</b>	<b>52,988</b>	<b>83,330</b>	<b>55,567</b>	<b>59,632</b>
Capital expenditures	(115,446)	(183,330)	(73,968)	(73,968)	(73,968)
Change in investments	(13,311)	1,629	(3,000)	(3,000)	(3,000)
Other investing cash flows	26,041	25,883	(6,633)	8,831	17,185
<b>Cash flow from investing</b>	<b>(102,715)</b>	<b>(155,818)</b>	<b>(83,601)</b>	<b>(68,136)</b>	<b>(59,783)</b>
Debt raised/repaid	40,845	133,493	69,059	60,000	100,000
Dividends paid	(28,355)	(28,355)	(51,716)	(60,633)	(73,116)
Other financing cash flows	10,131	(2,262)	0	0	0
<b>Cash flow from financing</b>	<b>22,621</b>	<b>102,876</b>	<b>17,342</b>	<b>(633)</b>	<b>26,884</b>
<b>Changes in cash and cash eq.</b>	<b>(10,867)</b>	<b>46</b>	<b>17,071</b>	<b>(13,202)</b>	<b>26,732</b>
<b>Closing cash and cash eq.</b>	<b>2,185</b>	<b>2,231</b>	<b>19,302</b>	<b>6,100</b>	<b>32,833</b>

**Per Share**

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	31.7	23.3	48.5	56.2	67.8
Adjusted EPS	31.7	29.9	48.5	56.2	67.8
Dividend per share	29.0	34.0	41.0	47.0	49.0
Book value per share	199.5	203.3	217.8	234.9	255.6

**Valuations Ratios**

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	0.1	0.2	0.3	0.2	0.2
EV/EBITDA	3.9	9.1	3.3	3.8	3.5
Adjusted P/E	6.5	6.9	4.2	3.7	3.0
P/BV	1.0	1.0	0.9	0.9	0.8

**DuPont Analysis**

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	53.0	248.7	63.1	66.4	72.3
Interest burden (PBT/EBIT)	126.4	162.9	98.2	108.4	105.7
EBIT margin (EBIT/Revenue)	2.6	0.4	6.2	4.8	4.2
Asset turnover (Revenue/Avg TA)	278.4	238.9	157.6	185.1	213.3
Leverage (Avg TA/Avg Equity)	3.5	3.7	3.8	3.9	4.0
Adjusted ROAE	17.3	14.9	23.1	24.8	27.6

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

**Ratio Analysis**

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
<b>YoY growth (%)</b>					
Revenue	25.4	(2.3)	(28.4)	29.0	30.1
EBITDA	4.5	(56.3)	231.8	1.9	13.1
Adjusted EPS	(33.1)	(5.7)	62.3	15.7	20.7
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	3.8	1.7	7.8	6.1	5.3
EBIT margin	2.6	0.4	6.2	4.8	4.2
Adjusted profit margin	1.8	1.7	3.9	3.5	3.2
Adjusted ROAE	17.3	14.9	23.1	24.8	27.6
ROCE	8.8	1.8	11.7	10.3	10.3
<b>Working capital days (days)</b>					
Receivables	7	7	8	7	7
Inventory	105	122	150	129	131
Payables	23	20	23	20	20
<b>Ratios (x)</b>					
Gross asset turnover	3.8	3.3	2.1	2.5	3.1
Current ratio	1.1	1.1	0.9	0.9	1.0
Net interest coverage ratio	9.2	1.0	5.3	3.9	3.3
Adjusted debt/equity	0.8	1.3	1.3	1.4	1.5

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

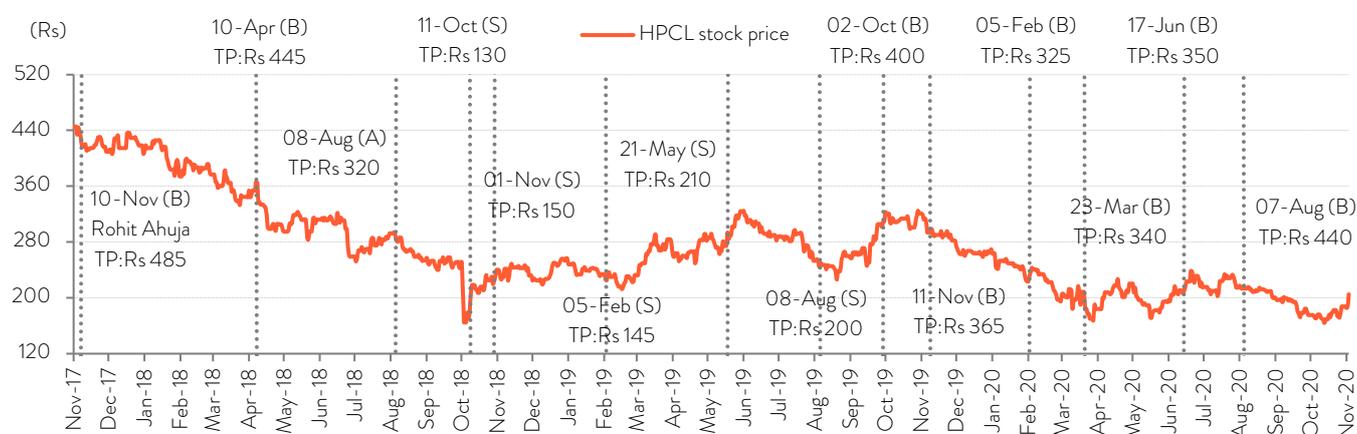
**ADD** – Expected return from >+5% to +15%

**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)

### RATINGS AND TARGET PRICE (3-YEAR HISTORY): HINDUSTAN PETROLEUM CORP (HPCL IN)



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

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