

BUY
TP: Rs 325 | ▲ 37%

**HINDUSTAN
PETROLEUM CORP**

Oil & Gas

05 February 2020

Earnings muted but largely priced in

HPCL's Q3FY20 PAT was below estimates due to subdued marketing business earnings of Rs 22bn (+12% YoY ex-inventory). Marketing EBITDA margins, however, remained resilient (at Rs 2,000/MT) and could sustain in the current benign crude price environment. GRMs were muted at US\$ 1.4/bbl (ex-inventory), leading us to cut estimates for FY20-FY22 by ~US\$ 1/bbl each – this translates to a 5-11% earnings downgrade. Rolling valuations forward, we have a revised Mar'21 TP of Rs 325 (from Rs 365).

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Robust marketing margins: HPCL's marketing segment posted below-expected earnings in Q3FY20, but continued to exhibit resilient EBITDA levels at Rs 2,000/MT (+3.4% YoY ex-inventory). The company gained market share in petroleum product sales, delivering sales volume growth of 3.5% against industry growth of 1.5%. Market share gains were driven by LPG and other industrial products, while HPCL lost ground in retail fuel sales (petrol and diesel). Considering the benign crude price environment, we raise our marketing margin assumptions by ~10% over FY21/FY22.

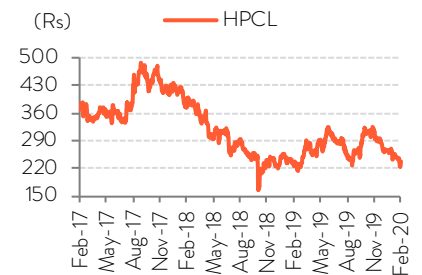
GRMs remain muted: HPCL continues to underperform on GRMs (US\$ 1.45/bbl in Q3 against US\$ 1.7/bbl for the Singapore benchmark). Singapore GRMs have currently fallen below US\$ 1/bbl. A relatively high diesel slate in the refining portfolio puts HPCL in an advantageous position, given that the new IMO regulations (effective Jan'20) are expected to push diesel spreads above US\$ 20/bbl (from ~US\$ 13 currently).

Maintain BUY: At 4.8x FY22E EBITDA, valuations seem to be pricing in the worst case of low GRMs and benign marketing margins.

Ticker/Price	HPCL IN/Rs 237
Market cap	US\$ 5.1bn
Shares o/s	1,524mn
3M ADV	US\$ 15.5mn
52wk high/low	Rs 334/Rs 211
Promoter/FPI/DII	51%/19%/30%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	2,186,469	2,742,552	2,763,318	3,362,091	3,775,944
EBITDA (Rs mn)	98,502	103,490	80,577	93,725	116,873
Adj. net profit (Rs mn)	72,183	66,900	59,129	60,636	73,463
Adj. EPS (Rs)	47.4	43.9	38.8	39.8	48.2
Adj. EPS growth (%)	(12.4)	(7.3)	(11.6)	2.5	21.2
Adj. ROAE (%)	31.0	23.9	18.5	17.3	19.0
Adj. P/E (x)	5.0	5.4	6.1	6.0	4.9
EV/EBITDA (x)	4.8	4.4	5.7	5.5	4.8

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Net sales	704,479	718,139	(1.9)	605,728	16.3	2,017,312	2,063,523	(2.2)
Purchases	477,808	448,577	6.5	407,228	17.3	1,396,765	1,341,998	4.1
% of sales	67.8	62.5	-	67.2	-	69.2	65.0	-
Other expenditure	211,019	262,910	(19.7)	178,216	18.4	568,278	667,837	(14.9)
% of sales	30.0	36.6	-	29.4	-	28.2	32.4	-
EBITDA	15,653	6,652	135.3	20,284	(22.8)	52,269	53,688	(2.6)
EBITDA margin (%)	2.2	0.9	-	3.3	-	2.6	2.6	-
Depreciation and amortisation	8,659	7,393	17.1	8,121	6.6	24,930	21,842	14.1
Interest	2,524	1,472	71.5	2,856	(11.6)	7,443	5,388	38.1
Other income	7,038	6,917	1.8	6,863	2.6	14,144	20,197	(30.0)
PBT	11,508	4,704	144.7	16,170	(28.8)	34,040	46,656	(27.0)
Provision for tax	4,036	2,228	81.1	5,647	(28.5)	8,875	16,068	(44.8)
PAT (adj.)	7,472	2,476	201.8	10,523	(29.0)	25,165	30,587	(17.7)
Other comprehensive income	-	(1,162)	-	-	-	-	(1,081)	(100.0)
Total income	7,472	1,313	469.0	10,523	(29.0)	25,165	29,507	(14.7)
NPM (%)	1.1	0.3	-	1.7	-	1.2	1.5	-
EPS (adj.) (Rs)	4.9	1.6	201.8	6.9	(29.0)	17.1	20.1	(14.7)
Reported GRMs (US\$/bbl)	1.8	3.7	(51.9)	2.8	(36.8)	1.8	5.2	(64.6)
Refining throughput (mmt)	4.2	4.6	(8.8)	4.6	(8.8)	12.6	13.8	(8.7)
Market sales (mmt)	10.6	9.7	8.6	9.4	12.6	30.1	28.6	5.1
Pipeline throughput (mmt)	5.1	5.2	(2.5)	5.1	0.8	15.5	15.9	(2.8)

Source: Company, BOBCAPS Research

FIG 2 – SEGMENT-WISE PERFORMANCE

Particulars	Q3FY20	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	9MFY20	9MFY19	YoY (%)
Crude throughput (mmt)	4.16	4.56	(8.8)	4.56	(8.8)	12.64	13.84	(8.7)
GRM (US\$/bbl)	1.79	3.72	(51.9)	2.83	(36.8)	1.83	5.17	(64.6)
Normalised GRMs (US\$/bbl)	1.45	10.27	(85.9)	2.56	(43.4)	3.79	5.36	(29.3)
Refining EBITDA (Rs mn)	(1,410)	3,095	-	1,140	-	16,040	37,130	(56.8)
Refining EBITDA (US\$/bbl)	(0.6)	1.3	-	0.5	-	2.4	5.3	(54.2)
Inventory gains/ (loss) (Rs mn)	740	(15,350)	-	660	12.1	(1,380)	13,960	-
Inventory gains/ (loss) (US\$/bbl)	0.34	(6.55)	-	0.27	24.3	(1.96)	(0.19)	-
Exchange fluctuation gain/(loss) (Rs mn)	590	2,300	(74.3)	(220)	368.2	(2,050)	(6,870)	(70.2)
Adjusted Refining EBITDA (Rs mn)	(2,740)	16,145	-	700	-	19,470	30,040	(35.2)
Adjusted Refining EBITDA (US\$/bbl)	(1.26)	6.89	-	0.29	-	2.96	4.31	(31.3)
Market sales:	10.58	9.74	8.6	9.40	12.6	30.07	28.60	5.1
Domestic sales	9.76	9.44	3.4	8.95	9.1	28.53	27.90	2.3
Exports	0.82	0.30	173.3	0.45	82.2	1.54	0.70	120.0
Marketing EBITDA (Rs mn)	24,470	3,558	587.8	25,290	(3.2)	50,080	50,590	(1.0)
Marketing EBITDA (Rs/MT)	2,313	365	533.2	2,690	(14.0)	2,333	1,523	53.2
Inventory gains/ (loss) (Rs mn)	2,690	(19,300)	-	(130)	-	2,800	22,110	87.3
Inventory gains/ (loss) (Rs/MT)	254	(1,982)	-	(14)	-	93	773	88.0
Exchange fluctuation gain/(loss) (Rs mn)	230	3,670	(93.7)	(1,000)	123.0	(6,220)	(16,230)	-
Adj. Marketing EBITDA (Rs mn)	21,550	19,188	12.3	26,420	(18.4)	53,500	44,710	19.7
Adj. Marketing EBITDA (Rs/MT)	2,037	1,970	3.4	2,811	(27.5)	1,779	1,563	13.8
Others EBITDA (Rs mn)	NA	-	-	720	-	NA	1,690	-
Reported EBITDA (Rs mn)	15,653	6,652	135.3	20,284	(22.8)	49,592	53,688	(7.6)

Source: Company, BOBCAPS Research

Valuation methodology

We cut GRM estimates for FY20-FY22 by ~US\$ 1/bbl each – this translates to a 5-11% earnings downgrade. Marketing EBITDA margins, however, remain resilient (at Rs 2,300/MT in Q3FY20) and could sustain in the current benign crude price environment. Rolling valuations forward, we have a revised Mar'21 target price of Rs 325 (from Rs 365). At 4.8x FY22E EBITDA, current valuations seem to be pricing in the worst case of low GRMs and benign marketing margins. Maintain BUY.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Revenue	2,738,792	2,713,395	(0.9)	3,301,787	3,267,134	(1.0)	3,715,327	3,680,988	(0.9)
EBITDA	74,920	80,577	7.5	74,313	93,725	26.1	91,301	116,873	28.0
EBITDA margin (%)	2.7	3.0	-	2.3	2.9	-	2.5	3.2	-
PAT	66,495	59,129	(11.1)	63,873	60,636	(5.1)	77,574	73,463	(5.3)
EPS (Rs)	43.6	38.8	(11.1)	41.9	39.8	(5.1)	50.9	48.2	(5.3)

Source: Company, BOBCAPS Research

Our SOTP-based target price of Rs 325 is based on the following:

- refining business valued at 6x FY22E EBITDA (lowered from 7x earlier), and
- marketing business valued at 5x FY22E EBITDA.

FIG 4 – SOTP VALUATION SUMMARY

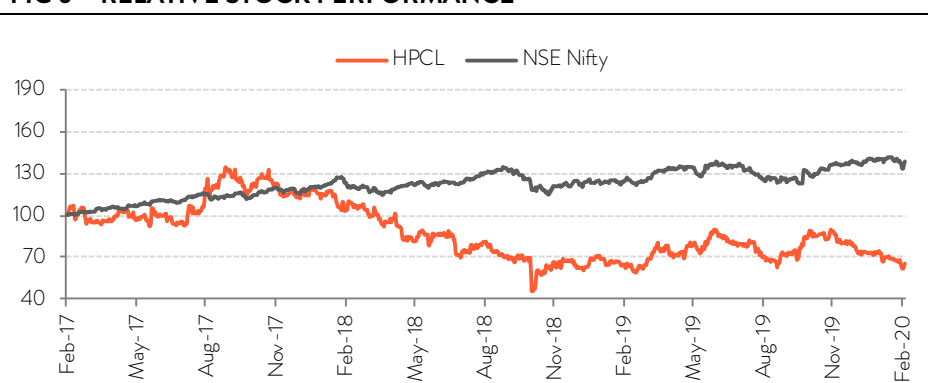
	EV (Rs bn)	Value (Rs/sh)	Comments
Refining Business	133	87	6x FY22E EBITDA
Marketing & others	429	282	5x FY22E EBITDA
Bhatinda refinery	78	51	6x FY22E EBITDA
Total core business	640	420	-
Less: Net debt	162	106	Adjusted for Bhatinda stake
Equity Value of core businesses	478	314	-
MRPL stake	10	7	20% discount to CMP
OIL stake	5	3	20% discount to CMP
HPCL's Equity Value (Rs)	493	325	8.1x FY22E EPS

Source: Company, BOBCAPS Research

FIG 5 – 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)	3.0	4.0	5.0
Crude throughput (mmt)	20.3	24.4	24.4
HMEL (Bhatinda)			
GRM (US\$/bbl)	11.0	12.0	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 6 – 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 lead to a change in government regulation on marketing margins for retail sales of petrol/diesel. This could trigger 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	2,763,318	3,362,091	3,775,944
EBITDA	98,502	103,490	80,577	93,725	116,873
Depreciation	(28,344)	(30,853)	(23,832)	(25,065)	(26,298)
EBIT	70,158	72,637	56,745	68,660	90,575
Net interest income/(expenses)	(6,179)	(7,856)	(13,727)	(21,783)	(29,883)
Other income/(expenses)	23,906	26,315	31,568	25,474	29,678
EBT	87,885	91,095	74,586	72,351	90,370
Income taxes	(28,919)	(33,486)	(19,256)	(19,526)	(24,718)
Min. int./Inc. from associates	(13,216)	(9,291)	(3,800)	(7,811)	(7,811)
Reported net profit	72,183	66,900	59,129	60,636	73,463
Adjusted net profit	72,183	66,900	59,129	60,636	73,463

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	158,459	190,534	169,168	211,323	237,627
Other current liabilities	46,701	45,261	60,004	73,102	81,841
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	254,082	258,111	263,212
Equity capital	15,242	15,242	15,242	15,242	15,242
Reserves & surplus	240,082	288,765	319,360	351,463	391,043
Shareholders' fund	255,324	304,007	334,602	366,705	406,285
Total liabilities and equities	896,718	1,074,226	1,227,781	1,377,385	1,525,327
Cash and cash eq.	13,052	2,185	26,197	22,416	31,270
Accounts receivables	55,870	56,674	59,472	71,608	80,679
Inventories	186,122	204,436	318,035	380,382	427,728
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	1,227,780	1,377,384	1,525,326

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	99,866	97,549	82,961	85,701	99,761
Changes in working capital	19,558	21,035	(119,047)	(15,200)	(16,275)
Other operating cash flows	(23,906)	(26,315)	(31,568)	(25,474)	(29,678)
Cash flow from operations	95,519	92,269	(67,654)	45,027	53,808
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	4,568	(1,526)	(2,322)
Cash flow from investing	(54,478)	(125,966)	(5,409)	(78,494)	(79,289)
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)	24,012	(3,781)	8,854
Closing cash and cash eq.	13,051	2,185	26,197	22,416	31,270

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	47.4	43.9	38.8	39.8	48.2
Adjusted EPS	47.4	43.9	38.8	39.8	48.2
Dividend per share	17.0	15.9	16.0	16.0	19.0
Book value per share	167.5	199.5	219.5	240.6	266.6

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	0.2	0.2	0.2	0.2	0.1
EV/EBITDA	4.8	4.4	5.7	5.5	4.8
Adjusted P/E	5.0	5.4	6.1	6.0	4.9
P/BV	1.4	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	79.3	83.8	81.3
Interest burden (PBT/EBIT)	125.3	125.4	131.4	105.4	99.8
EBIT margin (EBIT/Revenue)	3.2	2.6	2.1	2.0	2.4
Asset turnover (Revenue/Avg TA)	257.2	278.3	240.1	258.1	260.2
Leverage (Avg TA/Avg Equity)	3.6	3.5	3.6	3.7	3.8
Adjusted ROAE	31.0	23.9	18.5	17.3	19.0

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	0.8	21.7	12.3
EBITDA	(6.1)	5.1	(22.1)	16.3	24.7
Adjusted EPS	(12.4)	(7.3)	(11.6)	2.5	21.2
Profitability & Return ratios (%)					
EBITDA margin	4.5	3.8	2.9	2.8	3.1
EBIT margin	3.2	2.6	2.1	2.0	2.4
Adjusted profit margin	3.3	2.4	2.1	1.8	1.9
Adjusted ROAE	31.0	23.9	18.5	17.3	19.0
ROCE	10.4	8.8	6.6	6.5	7.6
Working capital days (days)					
Receivables	8	7	8	7	7
Inventory	132	105	137	138	137
Payables	25	24	24	21	22
Ratios (x)					
Gross asset turnover	3.3	3.8	3.5	4.1	4.5
Current ratio	1.0	1.0	1.0	1.0	1.0
Net interest coverage ratio	11.4	9.2	4.1	3.2	3.0
Adjusted debt/equity	0.8	0.8	1.1	1.2	1.2

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

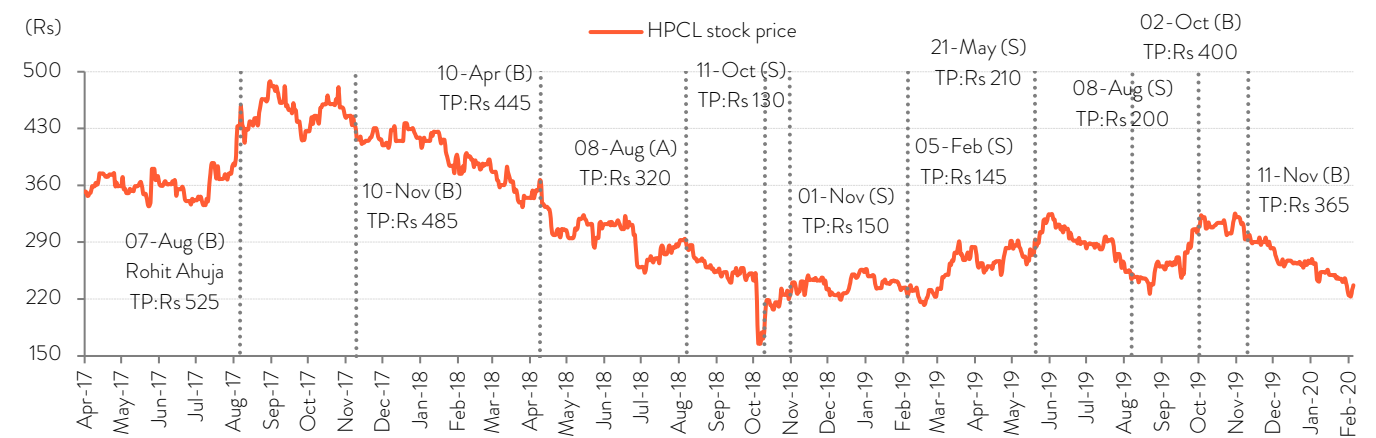
ADD – Expected return from >+5% to +15%

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)

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



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

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