Sharekhan
by BNP PARIBAS

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Stock Update

Bharat Petroleum Corporation Limited

Q3 exceeds hopes; multiple catalysts for re-rating

Oil & Gas	Sharekhan code: BPCL	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 419**	
Price Target: **Rs. 520**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

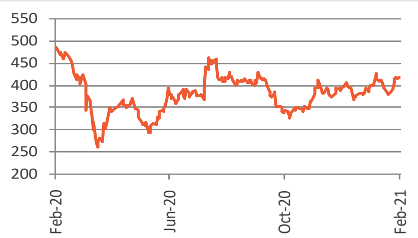
Company details

Market cap:	Rs. 90,968 cr
52-week high/low:	Rs. 495/252
NSE volume: (No of shares)	92.8 lakh
BSE code:	500547
NSE code:	BPCL
Free float: (No of shares)	102.0 cr

Shareholding (%)

Promoters	53.0
FII	11.6
DII	20.1
Others	15.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4	10	1	-14
Relative to Sensex	0	-9	-33	-39

Sharekhan Research, Bloomberg

Summary

- Q3FY21 was strong as operating profit/adjusted PAT at Rs. 4,306 crore/Rs. 3,058 crore, up 68%/133% y-o-y and beat of 22%/50% vs. street estimates led by strong performance in refining & marketing segment, higher other income and lower interest cost.
- BPCL's net marketing margin rose 2.2x y-o-y to Rs. 3,597/tonne and outperformed peers with highest GRM of $2.5/bbl, refinery utilisation (105%) and market share gain in petrol/diesel. Earnings also benefited from inventory/forex gain of Rs. 711 crore/Rs. 96 crore.
- Q4FY21 earnings could moderate due to weak marketing margins and lower inventory gain (crude valued at $53/bbl vs. spot oil price of $58/bbl). Strong outlook for FY22 led by cyclical GRM recovery, volume growth and normalisation of auto fuel marketing margins.
- Privatisation could re-rate BPCL as valuation of refining & marketing assets could get aligned to that of global peers and create long-term value for investors. Hence, we maintain a Buy on BPCL with a revised PT of Rs. 520.

Bharat Petroleum Corporation Limited's (BPCL's) Q3FY2021 adjusted operating profit stood at Rs. 4,306 crore (up 67.9% y-o-y; down 4% q-o-q), which was 22% above consensus estimate of Rs. 3,541 crore. Results beat expectations on largely all fronts with better-than-expected derived net marketing margin at Rs. 3,597/tonne (up 2.2x y-o-y; up 0.9% q-o-q), reported GRM at $2.5/bbl (versus estimate of $2-2.2/bbl) and refining throughput at 7.2 mmt (refinery utilization rate of 105%). Operating profit includes inventory gain of Rs711 crore (versus Rs. 539 crore in Q3FY2020) and forex gains of Rs. 96 crore (versus a forex loss of Rs. 96 crore in Q3FY2020). Marketing sales volume stood at 11.4mmt (up 23.1% q-o-q) was slightly below estimates but more importantly BPCL gained market share of 0.62 percentage points in petrol and 1.05 percentage points in diesel on sequential basis. Adjusted PAT of Rs. 3,058 crore (up 133.6% y-o-y, up 18.5% q-o-q) was also significantly above consensus estimate of Rs2,038 crore on account of beat in operating profit, higher other income (up 2.9x y-o-y) and lower interest cost (down 51% y-o-y) partially offset by higher effective income tax rate of 33% (versus assumption of 25%). We believe that inventory gains for BPCL would moderate in Q4FY2021 as its crude inventory is valued at $53/bbl (versus spot oil price of $58/bbl) while marketing margin are expected to weaken on q-o-q basis given inadequate revision in retail auto fuel price during January-February 2021 so far. Notwithstanding the likely weak Q4FY2021 earnings outlook, we expect overall earnings to remain strong over FY2022-FY2023 led by a cyclical recovery in the refining margins and a sustained improvement in marketing margin (as we expect the same to get normalised with gradual price hikes). Overall, we expect EBITDA/PAT CAGR of 23%/22% over FY2020-FY2023E along with improvement in RoE to 17-18% (versus 10.8% in FY2020). BPCL management expects divestment of Numaligarh Refinery to get completed by March 2021, which could fasten the process of BPCL privatisation (government aims to complete BPCL divestment in FY2022) and it could lead to re-rating, thereby creating long-term value for investors. Hence, we maintain a Buy rating on BPCL with a revised PT of Rs. 520.

Key positives

- BPCL reported GRM at $2.5/bbl was highest amongst the OMCs (IOCL/HPCL GRM of $2.2/$1.9 per bbl).
- Higher-than-expected refining throughput at 7.2 mmt (highest utilisation rate of 105% among OMCs) and market share gain in petrol/diesel.
- Decline in debt by 11% q-o-q to Rs. 24,674 crore as on December 31, 2020.

Key negatives

- ATF sales volumes still remained weak at 46% of pre-COVID levels in Q3FY2021.

Our Call

Valuation – Maintain Buy on BPCL with a revised PT of Rs. 520: We have increased our FY2021 earnings estimates to factor higher volumes (auto fuel market share gain), inventory gain and higher refinery utilisation rates and FY2022-FY2023 earnings revision reflects higher marketing sales volume assumption. We believe that privatization could re-rate BPCL as valuation of refining and marketing assets could get aligned to that of global peers and create long-term value for investors. Hence, we maintain a Buy rating on BPCL with a revised PT of Rs. 520 (rollover of valuation multiple to FY2023E EPS and upward revision in earnings estimates). At CMP, the stock trades 12.9x its FY2022E EPS and 12.1x its FY2023E EPS.

Key Risks

Prolonged weakness in refining margins and impact on petroleum demand, given COVID-19 and any further delay in government's efforts for privatisation.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	2,97,275	2,84,383	2,29,007	3,24,994	3,55,930
OPM (%)	4.0	2.3	6.4	3.5	3.4
Adjusted PAT	7,132	3,764	9,622	6,370	6,811
% YoY growth	-10.6	-47.2	155.6	-33.8	6.9
Adjusted EPS (Rs.)	36.3	19.1	48.9	32.4	34.6
P/E (x)	11.6	21.9	8.6	12.9	12.1
P/B (x)	2.2	2.5	2.3	2.2	2.1
EV/EBITDA (x)	9.9	20.3	8.9	11.2	10.6
RoNW (%)	20.1	10.8	27.8	17.2	17.5
RoCE (%)	23.3	9.9	21.0	14.8	14.8

Source: Company; Sharekhan estimates

Sharp beat in operating profit led by strong performance of marketing & refining segment

Q3FY2021 adjusted operating profit stood at Rs. 4,306 crore (up 67.9% y-o-y; down 4% q-o-q) was 22% above our consensus estimate of Rs. 3,541 crore. Results beat expectations on all fronts with better-than-expected derived net marketing margin at Rs. 3,597/tonne (up 2.2x y-o-y; up 0.9% q-o-q), reported GRM at $2.5/bbl (versus estimate of $2-2.2/bbl) and refining throughput at 7.2 mmt (refinery utilization rate of 105%). Operating profit includes inventory gain of Rs711 crore (versus Rs. 539 crore in Q3FY2020) and forex gains of Rs. 96 crore (versus a forex loss of Rs. 96 crore in Q3FY2020). Marketing sales volume stood at 11.4mmt (up 23.1% q-o-q) was slightly below estimates but more importantly BPCL gained market share of 0.62 percentage points in petrol and 1.05 percentage points in diesel on sequential basis. Adjusted PAT of Rs. 3,058 crore (up 133.6% y-o-y, up 18.5% q-o-q) was also significantly above consensus estimate of Rs2,038 crore on account of beat in operating profit, higher other income (up 2.9x y-o-y) and lower interest cost (down 51% y-o-y) partially offset by higher effective income tax rate of 33% (versus assumption of 25%). We have adjusted reported PAT of Rs2,778 crore (up 120.3% y-o-y) for an expense of Rs419 crore related to employee stock purchase scheme 2020.

Q3FY2021 results conference call highlights

- **Update on divestment of NRL and government stake in BPCL -** Management expects that divestment of BPCL's 61.65% stake in Numaligarh Refinery Ltd (NRL) would get completed by March 2021. The Assam state government would buy a 13.65% stake and the remaining would be bought by consortium of Oil India and Engineers India. The management has appointed an independent transaction advisor for valuation of NRL and expects same to get finalised within a month. The likely divestment of NRL would speed up privatisation of BPCL. The management said that its upon Department of Investment and Public Asset Management (DIPAM) to start the process of making the data room available to bidders.

- **Auto fuel sales volume recovered above pre-COVID level –** The management has indicated that domestic diesel sales grew by 2% y-o-y and petrol sales volume was up 6.8% y-o-y in Q3FY2021 and BPCL gained market share of 0.62 percentage points in petrol and 1.05 percentage points in diesel. Petrol volumes rose by 6.8% y-o-y and diesel volume declined by 1.05% y-o-y in January. The demand from urban area remains strong and witnessing better growth in rural markers. BPCL sales volume growth from highways was highest among PSUs.

- **Refinery utilisation and crack spreads –** Overall refinery utilisation rate improved to 105% in Q3FY2021 versus 82% in Q2FY2021 as compared to 75% in Q1FY2021. Mumbai refinery utilisation was at 115% versus ~95% in Q2FY2021, while the Kochi refinery's utilisation stood at 95% versus 72% in Q2FY2021. Motor spirit cracks were largely flat q-o-q at $3/bbl but still remained well below $8.2/bbl in Q3FY2020, while diesel cracks were down q-o-q to $4.3/bbl.

- **Capex guidance –** The company increased capex guidance to Rs. 9,000 crore for FY2021 from earlier guidance of Rs8000 crore. The company has spent Rs. 5,688 crore on capex in 9MFY2021. Out of the total capex for FY2021, the management plans to spend Rs. 2,000 crore on refining, Rs. 800 crore on petrochemicals, Rs. 3,600 crore on marketing and the remaining for the gas business & pipeline projects. FY2022 capex guidance is Rs. 10,000 crore, out of which – Rs. 2,600 crore would be spent on refining, Rs. 970 crore would be spent on petchem, Rs. 3,200 crore would be spent on marketing. The company has planned a capex of Rs. 8,300 crore for the CGD business over next eight years and $2-2.5 billion for the Mozambique E&P for two LNG trains (first train in H2CY2024).

- **PDPP project –** The management guided that two units of Propylene Derivatives Petrochemical Project (PDPP) at the Kochi refinery are expected to get commissioned by March 2021 and one more unit by May 2021. The company does not expect any meaningful earnings contribution from PDPP project in FY2022.

- **Crude inventory and valuation –** Crude inventories stood at 1.89 million tonnes (versus 1.23 million tonnes at the end of Q2FY2021) and is valued at $53/bbl as on December 30, 2020. Product inventory was flat q-o-q at 3 mmt as on December 30, 2020.

- **Marketing margin outlook –** The management has indicated that marketing margins on petrol and diesel has remained flat q-o-q in Q3FY2021 and are expected to sustain at current levels in medium term.

- **Borrowing continues to decline q-o-q –** Gross debt declined by 11% q-o-q to Rs. 24,674 crore as compared to Rs. 27,848 crore as of September 2020 and Rs. 34,545 crore as on March 31, 2020.

- The Bina Refinery GRM stood at $2.14/bbl (versus $11/bbl in Q2FY2021) and reported net loss of Rs. 200 crore versus a PAT of Rs. 230 crore in Q2FY2021. BPCL's management said that discussions are going on to acquire remaining stake in Bharat Oman Refineries Limited (BORL) and an announcement on the same would be made soon. BPCL holds 63.4% stake in BORL (which has refining capacity of 7.8mtpa).
- GRM for Numaligarh Refinery stood at $37/bbl (including benefit of excise duty) versus $38/bbl in Q2FY2021 and reported PAT of Rs. 830 crore versus Rs. 839 crore in Q2FY2021 versus Rs. 460 crore in Q1FY2021.
- Outstanding dues from the government further reduced to Rs. 2200 crore as of December 2020 versus Rs. 4,150 crore as of September 2020 and Rs. 6,200 crore as of March 2020.
- A sharp increase in other income was on the account of dividend income of Rs. 612 crore from NRL.
- The company has added 1,692 retail fuel outlets in 9MFY2021 and targets to add total 2000 new outlets in FY2021.
- BPCL commissioned a new crude jetty at Mumbai refinery and the same would help reduce freight cost with savings estimated at $1/bbl.

Results Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Net Sales	**66,731**	**74,733**	**-10.7**	**50,146**	**33.1**
Total Expenditure	62,426	72,029	-13.3	46,295	34.8
Reported operating profit	4,306	2,703	59.3	3,851	11.8
Adjusted operating profit	**4,306**	**2,564**	**67.9**	**4,485**	**-4.0**
Other Income	1,515	515	194.2	573	164.5
EBITDA	5,820	3,218	80.9	4,424	31.6
Interest	251	512	-51.0	13	1,885.7
Depreciation	994	973	2.1	989	0.5
Exceptional income/(expense)	-419	-67	NA	-125	NA
Reported PBT	4,156	1,733	139.8	3,298	26.0
Adjusted PBT	4,576	1,800	154.3	3,786	20.8
Tax	1,379	472	191.8	1,050	31.3
Reported PAT	2,778	1,261	120.3	2,248	23.6
Adjusted PAT	**3,058**	**1,309**	**133.6**	**2,581**	**18.5**
Equity Cap (cr)	197	197		197	
Reported EPS (Rs)	14.1	6.4	120.3	11.4	23.6
Adjusted EPS (Rs)	15.5	6.7	133.6	13.1	18.5
Margins (%)			**BPS**		**BPS**
Adjusted OPM	6.5	3.4	302.1	8.9	-249.2
Adjusted NPM	4.6	1.8	283.1	5.1	-56.4

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
GRM ($/bbl)	2.5	3.2	-23.5%	5.8	-57.4%
Inventory gain ($/bbl)	1.2	1.0	20.4%	4.3	-71%
Core GRM ($/bbl)	1.2	2.2	-44.1%	1.5	-20%
Refining throughput (mmt)	7.2	8.4	-13.9%	5.6	28.6%
Market sales (mmt)	11.4	12.3	-8.0%	9.2	23.1%
Refining inventory gain/(loss) – Rs crore	502	457	9.8%	1,303	-61.5%
Marketing inventory gain/(loss) – Rs crore	269	82	228.0%	1,150	-76.6%
Forex gain/(loss) – Rs crore	76	-96	NA	152	-50.0%

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector view - Likely recovery in refining margin to mid-cycle level, decent volume growth, better auto fuel marketing margins bode well for earnings of OMCs**

India's petrol and diesel consumption is expected to grow at 8% and 3% annually, respectively in the medium term, as penetration of two-wheelers and passenger cars improves and GDP growth normalises. A gradual reduction of global petroleum product inventories (given improvement in oil demand and reduction in refinery run-rates) could improve core refining margins to mid-cycle levels of $3-4/bbl over CY2021E-CY2022E. Privatisation of BPCL (if successful) could play a crucial role to align marketing margin on petrol to global standards. All the above factors bode well for sharp earnings growth for Indian OMCs.

■ **Company outlook - Inventory gain and marketing margin to be lower in Q4; cyclical GRM recovery and volume growth to drive earnings over FY2022-FY2023**

We believe that inventory gains for BPCL would moderate as its crude inventory is valued at $53/bbl (as compared to spot oil price of $59-60/bbl) while marketing margins are expected to weaken q-o-q given an inadequate revision in retail auto fuel price during January-February 2021 so far. Notwithstanding a likely weak Q4FY2021 earnings outlook, we expect overall earnings to remain strong over FY2022-FY2023 supported by a cyclical recovery in the refining margin, full benefit of normalized marketing sales volume t and sustained improvement in marketing margin (as we expect the same to get normalised with gradual price hikes). Overall, we expect EBITDA/PAT CAGR of 23%/22% over FY2020-FY2023E along with an improvement in RoE to 17-18% (versus 10.8% in FY2020).

■ **Valuation - Maintain Buy on BPCL with a revised PT of Rs. 520**

We have increased our FY2021 earnings estimates to factor higher volumes (auto fuel market share gain), inventory gain and higher refinery utilisation rates and FY2022-FY2023 earnings revision reflects higher marketing sales volume assumption. We believe that privatization could re-rate BPCL as valuation of refining and marketing assets could get aligned to that of global peers and create long-term value for investors. Hence, we maintain a Buy rating on BPCL with a revised PT of Rs. 520 (rollover of valuation multiple to FY2023E EPS and upward revision in earnings estimates). At CMP, the stock trades 12.9x its FY2022E EPS and 12.1x its FY2023E EPS.

One-year forward P/E (x) band

Source: Sharekhan Research

About company

BPCL is the second-largest oil marketing company (OMC) in India and is engaged in the business of crude oil refining and marketing of petroleum products. The company has a standalone refining capacity of 27.5mmt and retail fuel outlets of 16,492. The company also hold stake in exploration and production (E&P) blocks in Mozambique and Brazil. The company holds stakes in city-gas distribution and LNG import businesses through its joint venture companies.

Investment theme

The government's stake sale to private/foreign players would unlock real value of BPCL and could trigger re-rating of the company as valuation of its refining and marketing assets could get re-aligned to global peers. Additionally, the recent recovery in petroleum consumption, higher marketing margin, and lower interest cost are likely to lead to sharp recovery in earnings.

Key Risks

- Prolonged weakness in refining margins and impact on petroleum demand given COVID-19 situation.
- Any further delays in government's efforts for privatisation of BPCL.

Additional Data

Key management personnel

K Padmakar	Chairman and Managing Director
N. Vijayagopal	Director - Finance
Arun Kumar Singh	Director - Marketing

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.6
2	HDFC Asset Management Co Ltd	2.2
3	Employee Benefit Trust	2.0
4	SBI Funds Management Pvt Ltd	1.8
5	Vanguard Group Inc/The	1.6
6	Nippon Life India Asset Management	1.1
7	ICICI Prudential Asset Management	1.0
8	BlackRock Inc	1.0
9	Franklin Resources Inc	0.9
10	Mirae Asset Global Investments Company	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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