Powered by the Sharekhan 3R Research Philosophy

Bharat Petroleum Corporation Limited

Inventory gains lifts earnings; privatisation key re-rating catalyst

Oil & Gas	Sharekhan code: BPCL	Result Update

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

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 354**	
Price Target: **Rs. 495**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 76,857 cr
52-week high/low:	Rs. 550/252
NSE volume: (No of shares)	104.1 lakh
BSE code:	500547
NSE code:	BPCL
Free float: (No of shares)	102 cr

Shareholding (%)

Promoters	53.0
FII	12.0
DII	20.6
Others	14.5

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0	-14	-4	-33
Relative to Sensex	-2	-20	-22	-31

Sharekhan Research, Bloomberg

Summary

- Q2FY2021 adjusted operating profit at Rs. 4,485 crore/ Rs. 2,581 crore, up 101%/46% y-o-y) was above ours and the street's estimates due to higher-than-expected inventory gains at Rs. 2,453 crore, better volumes and lower interest costs.
- A sharp beat in reported GRM at $5.8/bbl (up 71.6% y-o-y) led by refinery inventory gains of $4.3/bbl; derived blended marketing EBITDA margin declined by 17% q-o-q to Rs. 3,565/tonne (below our estimate).
- The recent recovery in auto fuel volumes, above-average marketing margin and lower interest costs offers earnings visibility over FY2021E-FY2023E. We do not expect inventory gains in Q3FY21 as oil price has stabilised at $40/bbl.
- The recent 15% decline in stock price due to delay in disinvestment process provides an entry opportunity given potential for re-rating as privatization could align valuation to global peers. Hence, we recommend Buy on BPCL with PT of Rs495.

Bharat Petroleum Corporation Limited's (BPCL) Q2FY2021 adjusted operating profit at Rs. 4,485 crore (up 100.6% y-o-y; up 14.5% q-o-q) was 9.5% above our estimate of Rs. 4,097 crore. The beat was on the account of higher-than-expected refinery inventory gain of Rs. 2,453 crore (versus an inventory loss of Rs. 26 crore in Q2FY2020), better-than-expected refinery throughput at 5.6 million tonne (up 9.5% q-o-q with utilization rate of 82%) partially offset by miss in the marketing margins. The refinery inventory gain was much higher than expectation, at Rs. 1,303 crore ($4.3/bbl), which led to sharp beat in reported GRM at $5.8/bbl (up 71.6% y-o-y). Adjusted for inventory gain, BPCL's core GRM remained subdued at $1.5/bbl (but above our estimate of $1/bbl). The derived blended marketing EBITDA margin declined by 17% q-o-q (up 2.3x y-o-y) to Rs. 3,565/tonne (below our estimate of Rs. 4,312/tonne) while marketing sales volume at 9.2 million tonnes (down 14.7% y-o-y; up 10.8% q-o-q) was marginally ahead of our estimate of 9 million tonnes. Adjusting for Rs. 634 crore related one-time payment for VRS compensation and Rs270 crore for foreign exchange benefit, the PAT at Rs. 2,581 crore (up 45.7% y-o-y, up 24.3% q-o-q) was also significantly above our estimate of Rs. 2,310 crore on account of a beat in operating profit and lower interest cost (down 53% y-o-y excluding foreign exchange benefit) partially offset by higher effective income tax rate of 32%. We believe that the strong Q2FY2021 results was driven by inventory gains, which would not be sustained in H2FY2021 as crude oil price has stabilised at $40/bbl. Hence, earnings momentum would be driven by volume recovery (petrol and diesel sales volume returned to pre-COVID-19 level in October), overall improvement in marketing margin and benefit of Middle East crude discount (although core GRM to remain subdued at $1.5-2/bbl). Overall, we expect EBITDA/PAT CAGR of 21%/20% over FY2020-FY2023E along improvement in RoE to 17-19% (versus 10.8% in FY2020). Divestment of BPCL has been delayed (DIPAM extended deadline for EoI to November 16) due to COVID-19, which could delay government's target to complete the divestment by March-2021. Although there has been delays in divestment proves but privatisation could lead to strong re-rating of BPCL and create long term value for investors. Hence, we recommend Buy on BPCL with PT of Rs. 495.

Key Positives

- Better-than-expected reported and core GRM at $5.8/bbl and $1.5/bbl, respectively in Q2FY2021.
- Higher-than-expected refining throughput at 5.6 mmt (up 9.5% q-o-q) and marketing sales volume at 9.2 mmt (up 10.8% q-o-q).
- Sharp decline in debt by 19% y-o-y to Rs. 27,848 crore as on September 30, 2020.

Key Negatives

- Lower-than-expected derived blended marketing EBITDA margin at Rs. 3,565/tonne (down 17% q-o-q).

Our Call

Valuation – Recommend Buy on BPCL with PT of Rs. 495: We have increased our FY2021 earnings estimate to factor sharp beat in reported GRM in Q2FY2021 and have fine-tuned our FY2022E-FY2023E EPS. The recent recovery in auto fuel volumes, above average marketing margin and lower interest lower provides earnings visibility over the next couple of years. The recent a sharp decline in BPCL's stock price by 15% (due to delay in disinvestment process amid COVID-19) provides an good entry opportunity given potential for strong re-rating as privatization could align valuation of refining and marketing assets to global peers and create long-term value for investors. Hence, we recommend Buy rating on BPCL with PT of Rs. 495. At CMP, the stock trades 10.8x its FY2023E EPS, which is at a 9% discount to historical average one-year forward P/E multiple of 11.8x.

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	1,94,779	2,62,529	2,87,006
OPM (%)	4.0	2.3	6.3	4.3	4.1
Adjusted PAT	7,132	3,764	6,629	6,199	6,458
% YoY growth	-10.6	-47.2	76.1	-6.5	4.2
Adjusted EPS (Rs.)	36.3	19.1	33.7	31.5	32.8
P/E (x)	9.8	18.5	10.5	11.2	10.8
P/B (x)	1.9	2.1	2.0	1.9	1.8
EV/EBITDA (x)	8.7	18.2	9.6	10.4	10.1
RoNW (%)	20.1	10.8	19.4	17.2	17.0
RoCE (%)	23.3	9.9	15.8	14.4	14.2

Source: Company; Sharekhan estimates

Note: We now convert BPCL into a Stock Update; It was earlier a 'Viewpoint' under our coverage

Substantial beat in adjusted operating profit led by higher-than-expected inventory gain and lower interest cost

BPCL's Q2FY2021 adjusted operating profit at Rs4,485 crore (up 100.6% y-o-y; up 14.5% q-o-q), was 9.5% above our estimate of Rs. 4,097 crore on account of higher-than-expected inventory gains at Rs. 2,453 crore (versus inventory loss of Rs. 26 crore in Q2FY20), higher refinery throughput at 5.6 million tonnes (up 9.5% q-o-q) partially offset by a miss in marketing margin. Operating profit also benefited from Rs. 152 crore as compared of forex loss of Rs. 387 crore in Q2FY2020. We have adjusted operating profit by Rs. 634 crore related one-time payment for VRS compensation for employees. Reported GRM came in at $5.8/bbl (up 71.6% y-o-y) primarily led by refinery inventory gain of $4.3/bbl. Adjusted for inventory gain, BPCL's core GRM remained subdued at $1.5/bbl (but above our estimate of $1/bbl). Derived blended marketing EBITDA margin declined by 17% q-o-q (up 2.3x y-o-y) to Rs. 3,565/tonne (below our estimate of Rs. 4312/tonne) while marketing sales volume at 9.2 million tonnes (down by 14.7% y-o-y; up 10.8% q-o-q) was marginally ahead of our estimate of 9 million tonnes. Diesel sales volumes declined sharply by 15.5% y-o-y (up 10.3% q-o-q) to 3.9 mmt, while petrol sales volumes was down by 6.7% y-o-y (up 44.8% q-o-q) to 1.8 mmt. Reported PAT increased by 31.6% y-o-y and 8.3% q-o-q to Rs. 2,248 crore. Adjusting for one-time payment of Rs. 634 crore for VRS compensation and Rs. 270 crore for foreign exchange benefit, PAT stood at Rs. 2,581 crore (up 45.7% y-o-y, up 24.3% q-o-q) also significantly exceeded our estimate of Rs. 2,310 crore on account of beat in operating profit and lower interest cost (down 53% y-o-y excluding foreign exchange benefit) partially offset by higher effective income tax rate of 32%.

Q2FY2021 results conference call highlights

- **Update on divestment of government stake in BPCL** - Management has highlighted that the BPCL divestment process seems unlikely to be completed before March 2021 as Department of Investment and Public Asset Management (DIPAM) has extended the deadline for expression of India by interested parties to November 16, 2020 and due diligence process would take time. Although there has been delay due to COVID-19 but the government is very serious for the fast-track completion of BPCL divestment process.
- **Auto fuel sales volume recovered to normal level** – The management has indicated that both petrol and diesel marketing sales volume has recovered to pre-COVID-19 level in October 2020. However, aviation turbine fuel (ATF) sales volume still remains at 61% below the normal level. There has been sharp pick-up in the demand for auto fuels in the urban areas and better growth in rural markers.
- **Refinery utilisation and crack spreads** – Overall refinery utilisation rate improved to 82% in Q2FY2021 as compared to 75% in Q1FY2021. Mumbai refinery utilisation ~95%, while Kochi refinery utilisation stood at 72%. Refinery utilisation rate are expected to improve further as demand is back to pre-COVID-19 level for auto fuels. Motor Spirit cracks improved q-o-q to $2.9/bbl but still remained well below $7.9/bbl in Q2FY2020 while diesel cracks was at flat q-o-q at $4.9/bbl.
- **Crude inventory and valuation** - Crude inventories stood at 1.23 million tonnes (versus 1.62 million tonne at the end of Q1FY2021) and is valued at $43/bbl as of September 30, 2020. Hence, the management does not expect any inventory gain in Q3FY2020. The inventory gain in Q2FY2021 was primarily on the account of processing of low cost crude, which was procured in May and June. Product inventory was flat q-o-q at 3 mmt as of September 30, 2020.
- **Marketing margin outlook** - The management has indicated that marketing margins on petrol and diesel has declined in Q2FY2021 and are now at normalised level and expected to sustain at current levels.
- **Capex guidance** - The company maintained its capex guidance of Rs. 8,000 crore for FY2021E (versus capex of Rs. 7,064 crore in FY2020). The company has spent Rs. 2,500 crore on capex in H1FY2021. The company has capex plan of Rs1.24 lakh crore over next five years with plans to spent $1 billion on marketing, $2.5 billion for Mozambique E&P for two LNG trains (first train in H2CY2024) and Rs. 10,000-12,000 crore on gas projects.
- **Update on borrowing** - The company's gross debt declined by 19% y-o-y to Rs. 27,848 crore as compared to Rs. 34,545 crore as on March 31, 2020.
- Bina Refinery GRM stood at $11/bbl versus $3/bbl for Q1FY2020 and reported PAT of Rs230 crore versus net loss stood at Rs. 238 crore in Q1FY2021.
- GRM for Numaligarh Refinery stood at $38/bbl (including benefit of excise duty) versus $25/bbl in Q1FY2021 and reported PAT of Rs. 839 crore versus Rs. 460 crore in Q1FY2021.
- Outstanding dues from the government have reduced to Rs. 4,150 crore as compared to Rs. 6,200 crore as of March 2020.
- The company has added 962 retail fuel outlets in H1FY2021 and targets to add total 1800 new outlets in FY2021.

Results Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Net Sales	**50,146**	**64,341**	**-22.1**	**38,785**	**29.3**
Total Expenditure	46,295	61,966	-25.3	34,869	32.8
Reported operating profit	3,851	2,375	62.2	3,916	-1.7
Adjusted operating profit	**4,485**	**2,236**	**100.6**	**3,916**	**14.5**
Other Income	573	871	-34.3	593	-3.5
EBITDA	4,424	3,246	36.3	4,509	-1.9
Interest	13	639	-98.0	587	-97.8
Depreciation	989	953	3.8	996	-0.7
Exceptional income/(expense)	-125	-61	NA	0	NA
Reported PBT	3,298	1,655	99.3	2,926	12.7
Adjusted PBT	**3,786**	**1,716**	**120.7**	**2,926**	**29.4**
Tax	1,050	-53	NA	850	23.5
Reported PAT	2,248	1,708	31.6	2,076	8.3
Adjusted PAT	**2,581**	**1,771**	**45.7**	**2,076**	**24.3**
Equity Cap (cr)	197	197		197	
Reported EPS (Rs)	11.4	8.7	31.6	10.6	8.3
Adjusted EPS (Rs)	**13.1**	**9.0**	**45.7**	**10.6**	**24.3**
Margins (%)			**BPS**		**BPS**
Adjusted OPM	8.9	3.5	546.9	10.1	-115.2
Adjusted NPM	5.1	2.8	239.4	5.4	-20.7

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
GRM ($/bbl)	5.8	3.4	71.6%	0.4	NA
Inventory gain ($/bbl)	4.3	-0.4	NA	-1.5	NA
Core GRM ($/bbl)	1.5	3.8	-59.7%	1.9	-20%
Refining throughput (mmt)	5.6	7.7	-26.5%	5.1	9.5%
Market sales (mmt)	9.2	10.8	-14.7%	8.3	10.8%
Refining inventory gain/(loss) – Rs crore	1,303	-175	NA	-438	NA
Marketing inventory gain/(loss) – Rs crore	1,150	149	671.8%	1,003	14.7%
Forex gain/(loss) – Rs crore	152	-387	NA	-57	NA

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Low oil price environment and high auto fuel marketing margins bodes well for OMCs

India's petrol and diesel consumption is expected to grow at 8% and 3%, annually, as penetration for two-wheelers and passenger cars improves and GDP growth recovers to normal level. The sharp decline in crude oil prices would benefit oil marketing companies (OMCs) in terms of lower working capital requirement and above average auto fuel marketing margin. Although core refining margins could remain weak in the near term, gradual reduction of global petroleum product inventories (given improvement in oil demand and reduction refinery run rates) would improve refining margin in H2FY2021E. Moreover, Brent crude oil price at $40bbl is still well FY2020 levels of $61/bbl and would benefit refiners in terms of lower refinery fuel and loss.

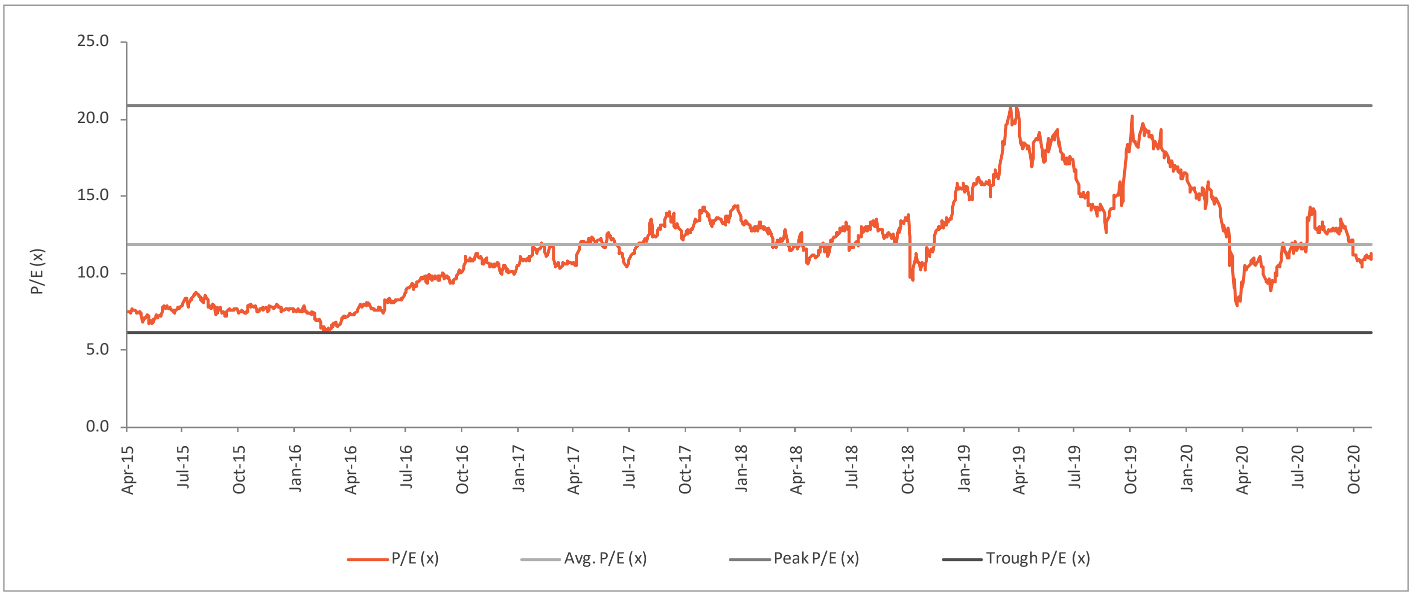
■ Company outlook - Higher auto fuel marketing margins, volume recovery and lower interest cost to aid earnings recovery

We believe that strong Q3FY2021 results was driven by inventory gains, which would not be sustained in H2FY2021 as crude oil price has stabilised at $40/bbl. Hence, earnings momentum would be driven by volume recovery (petrol and diesel sales volume to pre-COVID-19 level in October), overall improvement in marketing margin, benefit of Middle East crude discounts (although core GRM to remain subdued at $1.5-2/bbl) and lower interest cost. The company targets to gain a 200-bps market share in petrol and diesel in domestic market to 31% over next couple of years. Overall, we expect EBITDA/PAT CAGR of 21%/20% over FY2020-FY2023E along improvement in RoE to 17-19% (versus 10.8% in FY2020).

■ Valuation - Recommend Buy on BPCL with PT of Rs495

We have increased our FY2021 earnings estimate to factor sharp beat in reported GRM in Q2FY2021 and have fine-tuned our FY2022E-FY2023E EPS. The recent recovery in auto fuel volumes, above average marketing margin and lower interest lower provides earnings visibility over the next couple of years. The recent a sharp decline in BPCL's stock price by 15% (due to delay in disinvestment process amid COVID-19) provides an good entry opportunity given potential for strong re-rating as privatization could align valuation of refining and marketing assets to global peers and create long-term value for investors. Hence, we recommend Buy rating on BPCL with PT of Rs. 495. At CMP, the stock trades 10.8x its FY2023E EPS, which is at a 9% discount to historical average one-year forward P/E multiple of 11.8x.

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 over FY2021E-FY2022E.

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	2.7
3	SBI Funds Management Pvt Ltd	2.2
4	Vanguard Group Inc/The	1.6
5	ICICI Prudential Asset Management	1.4
6	Reliance Capital Trustee Co Ltd	1.1
7	BlackRock Inc	1.0
8	Franklin Resources Inc	0.9
9	Mirae Asset Global Investments Co	0.8
10	Norges Bank	0.7

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

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;