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Hindustan Petroleum Corporation Ltd

Weak GRM mars Q1; capex completion to fuel growth

Oil & Gas	Sharekhan code: HINDPETRO	Result Update

Stock 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. 265**	
Price Target: **Rs. 340**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

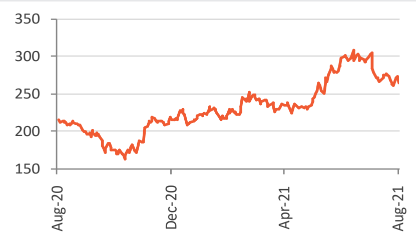
Company details

Market cap:	Rs. 37,584 cr
52-week high/low:	Rs. 312/163
NSE volume: (No of shares)	63.8 lakh
BSE code:	500104
NSE code:	HINDPETRO
Free float: (No of shares)	64.0 cr

Shareholding (%)

Promoters	54.9
FII	17.8
DII	16.3
Others	11.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-13	8	15	23
Relative to Sensex	-16	-3	9	-21

Sharekhan Research, Bloomberg

Summary

- Q1FY22 PAT at Rs. 1,795 crore (down 41% q-o-q) lagged estimate by 20% as reported GRM of $3.3/bbl sharply missed estimate and refinery/pipeline throughput was weaker than expected at 2.5 mmt/4.3 mmt, down 42.8%/19% q-o-q.
- Implied marketing margins rose 7% q-o-q (against an expected q-o-q decline) to Rs. 3,101/tonne led by auto fuel price hikes. Marketing sales volume of 8.8 mmt was in-line; refinery throughput fell due to shutdown for Mumbai refinery.
- Earnings to recover as volumes revive (petrol/diesel at >105%/~91% of pre-COVID level), likely structural improvement in auto fuel margin, cyclical recovery in GRM and inventory gains. Commissioning of Mumbai/Vizag refinery in FY22E would drive refinery throughput and FCF.
- Valuation of 4.3x/0.8 FY23E EPS/BV is attractive considering recovery in core earnings, RoE of 20% and dividend yield of 7-8%. BPCL's privatisation could re-rate OMCs. We maintain a Buy on HPCL with an unchanged PT of Rs. 340.

Hindustan Petroleum Corporation Limited (HPCL) reported weak standalone Q1FY2022 operating profit/PAT of Rs. 2,916 crore/Rs. 1,795 crore, down 33.2%/40.5% q-o-q. It also lagged our estimate of Rs. 3,408 crore/Rs. 2,251 crore by 14%/20%. Lower-than-expected earnings were on the account of a sharp miss in reported GRM at $3.3/bbl (versus estimate of $6/bbl) and weaker-than-expected refining/pipeline throughput at 2.5 mmt/4.3 mmt, down 42.8%/19% q-o-q. However, implied marketing margin was strong at Rs. 3101/tonne (up 7% q-o-q versus expectation of decline on lower petrol margin) while marketing sales volume of 8.8 mmt (down 12.9% q-o-q) was in line with our estimate. Refinery throughput was impacted due to shutdown of the Mumbai refinery (utilisation rate of only 25%) for capacity expansion and Vizag refinery (98% utilisation) due to a fire. HPCL gained a market share of 33 bps y-o-y in petrol to 24%, while that of diesel remained largely flat y-o-y at 21.5%. We expect HPCL's earnings to recover in the coming quarters, supported by multiple drivers such as volume recovery (petrol/diesel at >105%/~91% of pre-COVID level currently), higher refinery throughput (as utilisation rate would improve with pre-commissioning activities at the Mumbai Refinery is going on), sustained improvement in auto fuel marketing margins led by price hikes, cyclical recovery in refining margins over CY2021E-CY2022E as petroleum product cracks would improve with decline in the global petroleum inventories amid pick-up in global demand, and a likely inventory gain in Q2FY2022 as spot crude oil price of $75/bbl (versus $68.6/bbl in Q1FY2022). HPCL's valuation of 0.8x its FY2023E P/BV and 4.3x its FY2023E EPS (41% discount to historical multiples and 68% to that of BPCL) is attractive, given expectation of an improvement in core earnings, healthy RoE of 20% (best among OMCs) and dividend yield of 7-8% Hence, we maintain a Buy on HPCL with an unchanged PT of Rs. 340.

Key positives

- Implied marketing margin improved by 7% q-o-q to Rs3,101/tonne.
- Debt declined by 12% q-o-q to 35,197 crore as of June 2021.

Key negatives

- Lower-than-expected GRM of $3.3/bbl (versus estimate of $6/bbl) and underperformed IOCL GRM of $6.6/bbl).
- Mumbai refinery utilization at only 25% in Q1FY22 due to shutdown for expansion plan.

Our Call

Valuation – Maintain Buy on HPCL with an unchanged PT of Rs. 340: We have fine-tuned our FY2022 earnings estimates to factor in higher marketing margin offset by lower refinery through and have increased FY2023 earnings estimate to factor in higher auto fuel marketing margins. We have also introduced our FY2024 earnings estimates in this report. The stock's valuation of 4.3x its FY2023E EPS, 4.6x its FY2023E EV/EBITDA and 0.8x its FY2023E P/BV is attractive and not factoring in potential improvement in core earnings over FY2022-FY2023. Moreover, we expect that a healthy dividend yield of 7-8% on account of sustained strong earnings and completion of the capex cycle (refinery expansion at Mumbai and Vizag refinery in FY2022) would improve FCF generation from FY2023. Attractive valuation across parameters and a potential re-rating of marketing business (if BPCL is successfully privatised) makes us constructive on HPCL. We see a favourable risk-reward, given earnings visibility, attractive valuation and healthy dividend yield. Hence, we maintain a Buy on HPCL with an unchanged PT of Rs. 340.

Key Risks

Prolonged weakness in refining margin and lower-than-expected marketing sales volume amid the COVID-19 economic slowdown could impact earnings outlook and valuation.

Valuation (Standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E	FY24E
Revenue	2,67,600	2,31,913	2,63,472	2,85,428	2,98,602
OPM (%)	1.5	6.4	4.5	4.8	5.2
Adjusted PAT	2,092	10,664	7,629	8,823	10,010
% y-o-y growth	-65.3	409.7	-28.5	15.7	13.4
Adjusted EPS (Rs.)	14.7	75.2	53.8	62.2	70.6
P/E (x)	18.0	3.5	4.9	4.3	3.8
P/B (x)	1.3	1.0	0.9	0.8	0.7
EV/EBITDA (x)	17.9	5.0	5.7	4.6	3.8
RoNW (%)	7.3	32.7	19.9	20.4	20.5
RoCE (%)	6.3	21.7	15.1	16.6	18.2

Source: Company Data; Sharekhan estimates; Note: EPS calculation factors in reduced equity base post completion of recent buyback program

PAT below our estimate on weak refining performance

HPCL reported weak standalone Q1FY2022 operating profit/PAT of Rs. 2,916 crore/Rs. 1,795 crore, down 33.2%/40.5% q-o-q. It also lagged our estimate of Rs. 3,408 crore/Rs. 2,251 crore by 14%/20%. Lower-than-expected earnings were on the account of a sharp miss in reported GRM at $3.3/bbl (versus estimate of $6/bbl) and weaker-than-expected refining/pipeline throughput at 2.5 mmt/4.3 mmt, down 42.8%/19% q-o-q. However, implied marketing margin was strong at Rs. 3101/tonne (up 7% q-o-q versus expectation of decline on lower petrol margin) while marketing sales volume of 8.8 mmt (down 12.9% q-o-q) was in line with our estimate. Refinery throughput was impacted due to shutdown of the Mumbai refinery (utilisation rate of only 25%) for capacity expansion and Vizag refinery (98% utilisation) due to a fire. HPCL gained a market share of 33 bps y-o-y in petrol to 24%, while that of diesel remained largely flat y-o-y at 21.5%.

Q1FY2022 results conference call highlights

- **Auto fuel demand update and outlook on refinery utilisation –** The management indicated that the recovery in auto fuel demand is strong in July 2021 with petrol volumes at 5% above pre-COVID levels, while diesel volumes are at 91% of pre-COVID levels. Aviation turbine fuel (ATF) volumes are still at 55% of pre-COVID-19 level. Management expects diesel volume to recover post monsoon in the absence of third wave of COVID-19. In terms of refinery utilisation, the management expects the same to improve over Q2-Q3FY2022 and then reach normal levels.
- **Refinery utilisation impacted due to shutdowns –** Mumbai refinery utilization rate was only 25% in Q1FY22 due to complete shutdown for 45 days and a partial closure for the remainder of Q1FY22) related to revamp for expansion to 9.5 mtpa (from 7.5 MTPA currently). The Vizag refinery also operated at a lower utilisation rate of 98% due to shutdown because of a fire incident.
- **Mumbai refinery expansion nearing completion –** The management said that the Mumbai refinery expansion is nearing completion and pre-commissioning activities are going (to be completed in August 2021) on with commissioning expected in the next 1-2 months (i.e. September 2021). The estimated capex for Mumbai refinery expansion is at Rs. 5500 crore (98% already spent) and would take the capacity to 9.5 mtpa (from 7.5 mtpa currently).
- **Vizag refinery expansion –** The expansion plan for the Vizag refinery is on schedule to get completed in FY2022 (expect for Resid up-gradation project) and would increase the capacity to 13 mtpa by this fiscal end and to 15 mtpa on completion of full project (estimated capex of Rs. 26,000 crore and have spent Rs. 15000 crore till date). Overall, the management guided for incremental GRM of $6/bbl from Vizag expansion post completion of Resid up-gradation and it will become zero fuel oil refinery post expansion.
- **Rajasthan Refinery –** 9 mmt Rajasthan refinery and 2mtpa petrochemical capacity is on schedule to get completed by FY2024. The company has been receiving critical equipments for refinery and has spent Rs. 8000 crore on Rajasthan refinery till date.
- **Capex guidance –** The company has guided for a Rs14500 crore capex for FY2022E with Rs. 5000 crore each on the marketing and refining businesses and the remaining on JVs.
- **MS/HSD crack spread –** The management has said that crack spreads on petrol and diesel has improved to $8.1/bbl (versus $0.5/bbl in Q1FY21) and $5/bbl (versus $3.2/bbl in Q1FY21).
- **Retail outlets addition and CNG stations –** The company added 142 new retail outlets in Q1FY22 and thus taking total retail outlets to 18,776 as of June 2021. The company has a total of 724 stations versus 671 CNG stations as of March 2021. Also, 87 fuel retail outlets have EV charging facilities and 25% of its retail outlets are solarised.
- HPCL and Tata Power has signed an agreement to provide end-to-end EV charging stations at HPCL's retail outlets. Initially it will be on pilot basis for 100 retail fuel stations. HPCL has a partnership with five companies for EV charging facilities.
- Debt (including lease obligations) stood at Rs. 35,197 crore as of June 2021 as compared to Rs. 40,009 crore as of March 2021 and Rs. 36,655 crore as of June 2020.
- Outstanding dues from government stood at flat q-o-q at Rs. 300 crore as of June 2021.

Results (standalone) Rs cr

Particulars	Q1FY22	Q1FY21	y-o-y (%)	Q4FY21	q-o-q (%)
Net Sales	72,166	37,498	92.5	74,545	-3.2
Total Expenditure	69,250	33,367	107.5	70,177	-1.3
Reported operating profit	2,916	4,131	-29.4	4,368	-33.2
Adjusted operating profit	**2,916**	**4,131**	**-29.4**	**4,368**	**-33.2**
Other Income	649	785	-17.4	843	-23.0
EBITDA	3,565	4,916	-27.5	5,211	-31.6
Interest	254	322	-21.0	205	23.8
Depreciation	914	866	5.5	937	-2.5
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	**2,397**	**3,728**	**-35.7**	**4,068**	**-41.1**
Adjusted PBT	2,397	3,728	-35.7	4,068	-41.1
Tax	602	915	-34.2	1051	-42.7
Reported PAT	1,795	2,814	-36.2	3,018	-40.5
Adjusted PAT	**1,795**	**2,814**	**-36.2**	**3,018**	**-40.5**
Equity Cap (cr)	152	152	0.0	152	0.0
Reported EPS (Rs)	11.8	18.5	-36.2	19.8	-40.5
Adjusted EPS (Rs)	11.8	18.5	-36.2	19.8	-40.5
Margins (%)			**BPS**		**BPS**
Adjusted operating profit margin (OPM)	4.0	11.0	-697.6	5.9	-181.8
Adjusted net profit margin (NPM)	2.5	7.5	-501.7	4.0	-156.1
Tax rate	25.1	24.5	58.0	25.8	-71.2

Source: Company; Sharekhan Research

Key operating metrics

Operating performance	Q1FY22	Q1FY21	YoY (%)	Q4FY21	QoQ (%)
Reported GRM ($/bbl)	3.3	0.0	8175.0	8.1	-59.2
Refining throughput (mmt)	2.5	4.0	-36.8	4.4	-42.8
Market sales including exports (mmt)	8.8	7.6	15.9	10.1	-12.9
Pipeline throughput (mmt)	4.3	3.5	22.6	5.4	-19.0

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector view - Recovery in GRM to mid-cycle level, decent volume growth, and better auto fuel marketing margins bode well for earnings of OMCs**

India's consumption of petrol and diesel is expected to grow at decent rate annually in the medium term, as penetration for two-wheelers and passenger cars improves and GDP growth normalises. We believe that OMCs' auto fuel marketing margins would soon normalise to historical levels as they have started daily auto fuel price revisions. Moreover, gradual reduction of global petroleum product inventories (given an improvement in oil demand and a reduction in refinery run-rates) could improve core refining margin to mid-cycle level of $3-4/bbl over CY2021E-CY2022E. Privatisation of BPCL (is successful) could play a crucial role to align marketing margins on petrol to global standards. All the above factors bode well for sharp earnings growth for Indian OMCs.

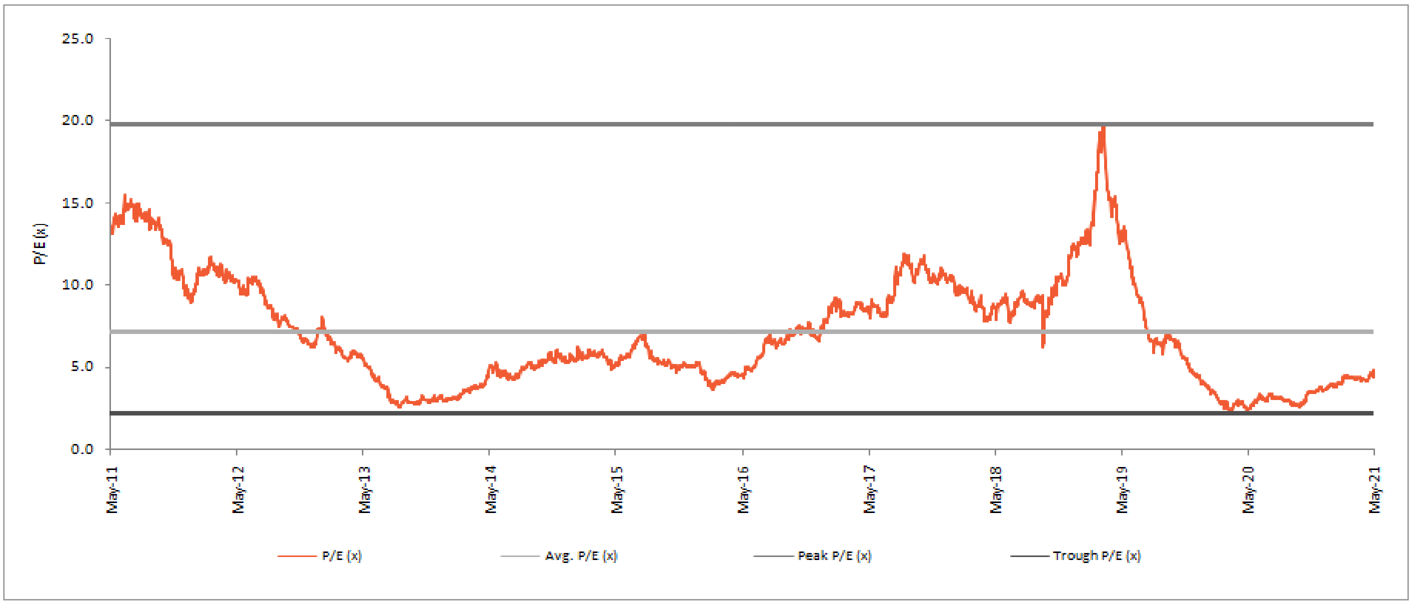
■ **Company outlook - Earnings to recovery led by cyclical recovery in GRM & volume and higher marketing margin**

We expect HPCL's earnings to recover in the coming quarters, supported by multiple drivers such as volume recovery (petrol/diesel at >105%/~91% of pre-COVID level currently), higher refinery throughput (as utilization rate would improve with pre-commissioning activities at MR is going on), sustained improvement in auto fuel marketing margin led by price hike, cyclical recovery in refining margin over CY2021E-CY2022E as petroleum product cracks would improve with decline in the global petroleum inventories amid pick-up in global demand, and likely inventory gain in Q2FY2022 as spot crude oil price of $75/bbl (versus $68.6/bbl in Q1FY2022).

■ **Valuation - Maintain Buy on HPCL with an unchanged PT of Rs. 340**

We have fine-tuned our FY2022 earnings estimates to factor in higher marketing margin offset by lower refinery through and have increased FY2023 earnings estimate to factor in higher auto fuel marketing margins. We have also introduced our FY2024 earnings estimates in this report. The stock's valuation of 4.3x its FY2023E EPS, 4.6x its FY2023E EV/EBITDA and 0.8x its FY2023E P/BV is attractive and not factoring in potential improvement in core earnings over FY2022-FY2023. Moreover, we expect that a healthy dividend yield of 7-8% on account of sustained strong earnings and completion of the capex cycle (refinery expansion at Mumbai and Vizag refinery in FY2022) would improve FCF generation from FY2023. Attractive valuation across parameters and a potential re-rating of marketing business (if BPCL is successfully privatised) makes us constructive on HPCL. We see a favourable risk-reward, given earnings visibility, attractive valuation and healthy dividend yield. Hence, we maintain a Buy on HPCL with an unchanged PT of Rs. 340.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

HPCL is engaged into the business of crude oil refining and marketing of petroleum products. The company has a standalone refining capacity of 15.8 mmt and retail fuel outlets of 18,776. HPCL also operates petroleum product pipeline network of 3,370 km with mainline capacity of 24.9mtpa and branch line capacity of 11.1mtpa and markets ~39 mmt of petroleum products.

Investment theme

HPCL is best placed among the OMCs given higher gearing toward marketing margins and lower impact on refinery throughput as it sources ~58% of petrol and diesel marketing sales volume from other refiners. Moreover, higher auto fuel marketing margin and sharp recovery in marketing sales volume bodes well for earnings recovery for OMCs. Moreover, HPCL's valuation is also attractive with steep discount to that of BPCL.

Key Risks

- Lower-than-expected refining and marketing margins could affect earnings outlook.
- Lower-than-expected volume in case of prolonged economic slowdown amid COVID-19.
- Volatility in quarterly earnings in case of fluctuations in oil prices and Re-USD rate.

Additional Data

Key management personnel

Mukesh Kumar Surana	Chairman & Managing Director
Rajneesh Narang	Director - Finance
Vinod S Shenoy	Director – Refineries
Rakesh Misri	Director - Marketing

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co. Ltd	5.2
2	Life Insurance Corp. of India	2.2
3	Vanguard Group Inc	1.8
4	BlackRock Inc	1.5
5	Franklin Resources Inc.	1.3
6	FRANKLIN ENTERP INC	1.2
7	Mirae Asset Global Investments Co. Ltd	1.1
8	SBI Funds Management Pvt. Ltd	0.7
9	Aditya Birla Sun Life Asset Management Co. Ltd	0.7
10	ICICI Prudential Life Insurance Co. Ltd	0.7

Source: Bloomberg

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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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