Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update | **Result Update**

Hindustan Petroleum Corporation Ltd

Weak Q4; negative marketing margin remains a concern

Oil & Gas	Sharekhan code: HINDPETRO

Reco/View: Buy	↔	CMP: Rs. 244	Price Target: Rs. 310	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 39.66

Updated Apr 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 34,598 cr
52-week high/low:	Rs. 355/237
NSE volume: (No of shares)	41.1 lakh
BSE code:	500104
NSE code:	HINDPETRO
Free float: (No of shares)	64.0 cr

Shareholding (%)

Promoters	54.9
FII	19.9
DII	15.1
Others	10.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-18.9	-16.8	-24.6	-11.7
Relative to Sensex	-12.7	-11.0	-15.7	-19.2

Sharekhan Research, Bloomberg

Summary

- Q4FY22 operating profit of Rs. 1,752 crore (up 14.6% q-o-q) sharply missed street estimate on high losses in the marketing business partially offset by GRM recovery. PAT of Rs. 1,795 crore beat estimates on higher other income and lower tax rate.
- Reported GRM of $12.4/bbl was above our estimate but refining throughput/marketing sales volume/pipeline throughput was below estimate at 4.7 mmt/10.7 mmt/5.3 mmt, up 10.6%/1.2%/down 3.3% q-o-q.
- Record Singapore GRM of >$20/bbl in Q1FY23 QTD would help cushion against negative motor-spirit/high-speed diesel's marketing margin to some extent. Thus, a fall in crude oil prices or likely steep HSD/MS retail price hike and MS/HSD excise duty cut remain key for improvement in marketing margins.
- Volatile marketing performance make us cut our PE to 4.5x FY24E EPS and thus we lower our PT to Rs. 310 while maintain our Buy on HPCL given attractive valuation of 3.6x/0.7x FY24E EPS/BV and a healthy dividend yield of ~6%.

Hindustan Petroleum Corporation Limited's (HPCL) Q4FY22 standalone operating profit of Rs. 1,752 crore (down 59.9% y-o-y; up 14.6% q-o-q) sharply missed consensus estimate of Rs. 2750 crore primarily due to massive losses in the marketing business as MS/HSD margin turned negative because of non-revision of the retail prices. Refining segment performed well with robust reported GRM of $12.4/bbl (up 53.4% y-o-y; up 94.7% q-o-q) above our estimate of $11.5/bbl but below that of IOCL at $18.5/bbl. Volume growth lagged our expectation with refinery throughput/marketing sales volume of 4.7 mmt/10.7 mmt, up 10.6%/1.2% q-o-q and pipeline throughput of 5.3 mmt, down 3.3% q-o-q. PAT at Rs. 1,795 crore (down 40.5% y-o-y; up 106.6% q-o-q) was sharply above our/street estimate of Rs. 622 crore/1,620 crore due to higher other income (up 131% y-o-y) and lower tax rate of 21%.

Key positives

- GRMs of $12.4/bbl, up 95% q-o-q and above our estimate of $11.5/bbl.
- Board approved dividend of Rs. 14/share, which implies dividend yield of ~6%.

Key negatives

- Weak marketing performance with negative MS/MSD margin.

Revision in estimates – We cut our FY23-24 earnings estimate to factor in negative marketing margins amid elevated crude oil/product prices partially offset by higher GRM assumption.

Our Call

Valuation – Maintain Buy on HPCL with a revised PT of Rs. 310: Sustained high crude oil price is a risk to auto fuel marketing margin and would keep earnings under pressure despite a sharp recovery in refining margin. We cut our PE multiple to 4.5x standalone FY24E PES and lower our price target to Rs. 310, while maintaining Buy rating on HPCL noting inexpensive valuation of 3.6x/0.7x its FY2024E EPS/BV and a healthy dividend of 6%. A fall in crude oil prices or likely steep retail price hike and excise duty cut in high-speed diesel (HSD)/motor spirit (MS) remain key for improvement in marketing margins and earnings recovery.

Key Risks

Sustained weak auto fuel marketing margin and a steep fall in refining margins remains key risk to earnings and valuation.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	2,31,913	3,48,428	4,17,164	3,73,252
OPM (%)	6.4	2.6	2.0	4.1
Adjusted PAT	10,664	6,383	4,821	9,694
% y-o-y growth	409.7	-40.1	-24.5	101.1
Adjusted EPS (Rs.)	75.2	45.0	34.0	68.3
P/E (x)	3.2	5.4	7.2	3.6
P/B (x)	1.0	0.9	0.8	0.7
EV/EBITDA (x)	4.8	8.1	6.8	3.7
RoNW (%)	32.7	17.0	11.9	21.7
RoCE (%)	21.7	11.6	9.5	17.7

Source: Company; Sharekhan estimates

Weak Q4 as loss in marketing offsets GRM recovery

Q4FY22 standalone operating profit of Rs. 1,752 crore (down 59.9% y-o-y; up 14.6% q-o-q) sharply missed consensus estimate of Rs. 2750 crore primarily due to massive losses in the marketing business as MS/HSD margin turned negative because of non-revision of the retail prices. Refining segment performed well with robust reported GRM of $12.4/bbl (up 53.4% y-o-y; up 94.7% q-o-q) above our estimate of $11.5/bbl but below that of IOCL at $18.5/bbl. Volume growth lagged our expectation with refinery throughput/marketing sales volume of 4.7 mmt/10.7 mmt, up 10.6%/1.2% q-o-q and pipeline throughput of 5.3 mmt, down 3.3% q-o-q. PAT at Rs. 1,795 crore (down 40.5% y-o-y; up 106.6% q-o-q) was sharply above our/street estimate of Rs. 622 crore/1,620 crore due to higher other income (up 131% y-o-y) and lower tax rate of 21%.

Results (standalone) Rs cr

Particulars	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)
Revenue	**97,227**	**74,545**	**30.4**	**96,260**	**1.0**
Total Expenditure	95,474	70,177	36.0	94,732	0.8
Reported operating profit	**1,752**	**4,368**	**-59.9**	**1,529**	**14.6**
Other Income	1,944	843	130.5	893	117.8
Interest	328	205	59.9	236	39.2
Depreciation	1083	937	15.6	1025	5.7
PBT	**2,285**	**4,069**	**-43.8**	**1,161**	**96.9**
Tax	490	1051	-53.4	292	67.8
Reported PAT	**1,795**	**3,018**	**-40.5**	**869**	**106.6**
Equity Cap (cr)	142	142	0.0	142	0.0
Reported EPS (Rs.)	12.7	21.3	-40.5	6.1	106.6
Margins (%)			**BPS**		**BPS**
OPM	1.8	5.9	-405.7	1.6	21.4
NPM	1.8	4.0	-220.2	0.9	94.4
Tax rate	21.4	25.8	-439.0	25.1	-370.8

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q4FY22	Q4FY21	YoY (%)	Q3FY22	QoQ (%)
Reported GRM ($/bbl)	12.4	8.1	53.4	6.4	94.7
Refining throughput (mmt)	4.7	4.4	6.8	4.2	10.6
Market sales including exports (mmt)	10.7	10.1	5.2	10.5	1.2
Pipeline throughput (mmt)	5.3	5.4	-0.7	5.5	-3.3

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - High GRM bodes for OMCs; elevated crude a concern

India's consumption of petrol and diesel is expected to grow at a decent rate annually in the medium term, as penetration for two-wheelers and passenger cars improves and GDP growth normalises. Geopolitical concerns and improvement in petroleum product demand bodes well for refining margin and expect the same to remain elevated in the near term before normalization to $5-6/bbl in latter part of CY2022E. Although high crude oil prices are a near-term concern for HSD/MS marketing margin, but we believe the same would normalise to historical levels of Rs. 2.5-3/litre with either steep rise in retail price and rationalisation of excise duty.

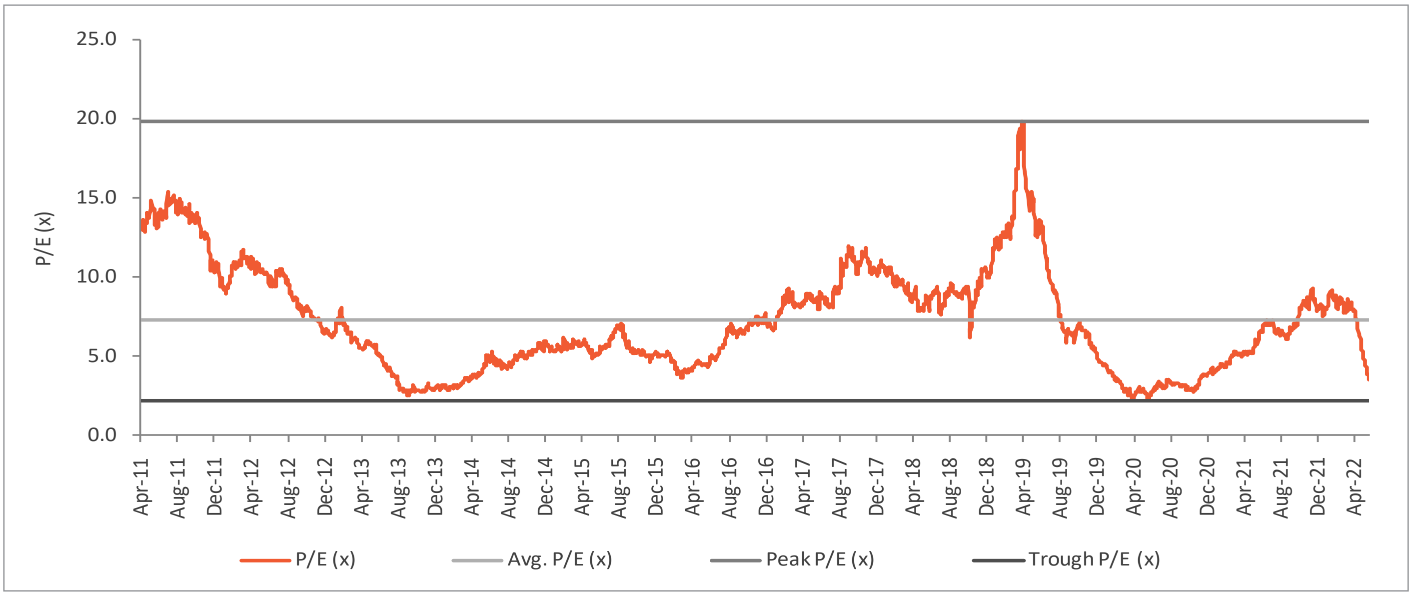
■ Company outlook - Near-term earnings headwinds on weak marketing margin

We expect HPCL's earnings to remain muted in H1FY23 due to negative marketing margin on MS/HSD given inadequate price revision amid elevated crude oil price and high products cracks. Weak marketing performance would get somewhat offset by record level of refining margin (supported by MS, HSD and jet kero crack spreads). Overall, we expect HPCL's standalone PAT to decline sharply by 25% y-o-y in FY23 but see a strong recovery of 101% y-o-y in FY24 a marketing segment's profitability would normalize gradually. A likely normalization of international oil price, steep MS/HSD retail price hikes or rationalization of petrol/diesel excise duty remain key for earnings revival for OMCs.

■ Valuation - Maintain Buy on HPCL with a revised PT of Rs. 310

Sustained high crude oil price is a risk to auto fuel marketing margin and would keep earnings under pressure despite a sharp recovery in refining margin. We cut our PE multiple to 4.5x standalone FY24E PES and lower our price target to Rs. 310, while maintaining Buy rating on HPCL noting inexpensive valuation of 3.6x/0.7x its FY2024E EPS/BV and a healthy dividend of 6%. A fall in crude oil prices or likely steep retail price hike and excise duty cut in high-speed diesel (HSD)/motor spirit (MS) remain key for improvement in marketing margins and earnings recovery.

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 17.8 mmt (post recent capacity expansion at Mumbai refinery) and retail fuel outlets of 19,602. HPCL also operates petroleum product pipeline network with capacity of 27mtpa and markets ~39 mmt of petroleum products. The company is under process to expand is Vizag refinery to 15mtpa by March'22 and is implementing refinery project with capacity of 9mtpa at Barmer in Rajasthan.

Investment theme

HPCL is expected to benefit from recent sharp surge in the refining margin amid geopolitical tension but inadequate petrol/diesel retail price despite high crude/petroleum products prices remain a near term concern on marketing margin. However, HPCL's valuation is also attractive and the stock offers healthy dividend yield.

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	4.7
2	Life Insurance Corp. of India	2.6
3	Vanguard Group Inc/ The	1.8
4	Republic of Singapore	1.6
5	BlackRock Inc	1.5
6	Mirae Asset Global Investments Co. Ltd	1.2
7	Franklin Resources Inc.	0.8
8	SBI Funds Management Ltd	0.8
9	UTI Asset Management Co. Ltd	0.7
10	ICICI Prudential Life Insurance Co. Ltd	0.7

Source: Bloomberg; old data

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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