Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Bharat Petroleum Corporation Ltd

Weak Q1; maintain Buy on attractive valuation

Stock Update

Result Update

Oil & Gas	Sharekhan code: BPCL
Reco/View: Buy ↔	CMP: Rs. 336
Price Target: Rs. 375 ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q1FY23 net loss of Rs. 6,291 crore was higher than our estimates due to a massive loss in the marketing business, a significant forex loss and marketing inventory loss that was partially offset by super strong GRM.
- Large negative auto fuel marketing margins continued to dent marketing segment's performance; refining segment's performance was robust with best-ever GRM of $27.5/bbl (up 80% q-o-q) and beat in refining throughput at 9.7mmt (up 19% q-o-q).
- We believe that H1FY23 would factor in the worst for OMCs and gradual petrol/diesel price hikes or a sustained fall in crude oil price (Brent crude price down to $95/bbl) would help normalise marketing margins. This coupled with a recovery in refining margins would help earnings recover over H2FY23-FY24.
- We maintain a Buy on BPCL with and unchanged PT of Rs.375 given attractive valuation of 8x/1.4x FY24E EPS/BV and FY24E dividend yield of 5%.

Bharat Petroleum Corporation Limited (BPCL) reported higher-than-expected standalone operating loss of Rs. 5,092 crore in Q1FY23 (versus an operating profit of Rs. 4,249 crore in Q4FY22) due to a larger-than-expected loss (large negative marketing margin on petrol/diesel on non-revision of retail prices) in the marketing business, a huge forex loss of Rs. 965 crore and marketing inventory loss of Rs. 371 crore (versus gain of Rs. 3,177 crore in Q4FY22). This was partially offset by a beat in reported GRM at $27.5/bbl (up 80% q-o-q and versus our estimate of $22/bbl). Volume performance was mixed with refining throughput beat estimates at 9.7 mmt, up 19.3% q-o-q but lower-than-expected marketing sales volume at 12.3 mmt, down 2.6% q-o-q. The company reported a net loss of Rs. 6,291 crore (almost double versus our expectations of a net loss of Rs. 3,138 crore) primarily on losses in marketing business, higher forex/marketing inventory loss and higher-than-expected depreciation (up 26.5% q-o-q).

Key positives

- Sharp beat in reported GRM at $27.5/bbl (up 80% q-o-q) versus our estimate of $22/bbl.

Key negatives

- Large negative marketing margin on automobile fuels due to non-revision of petrol/diesel prices.

Revision in estimates – We now estimate BPCL to report net loss in FY23 due to marketing losses in H1FY23 and weakening GRM. We have fine-tuned our FY24 earnings estimates.

Our Call

Valuation –Maintain Buy on BPCL with an unchanged PT of Rs.375: We believe that H1FY23 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins (led by a recent sharp decline in Brent crude oil price to $95/bbl) would lead to overall earnings recovery. Moreover, BPCL's valuation of 8x its FY2024E EPS and 1.4x its FY2024E P/BV is attractive and FY24E DPS implies a 5% dividend yield. Hence, we maintain a Buy on BPCL with an unchanged PT of 375.

Key Risks

Sustained weak automobile fuel marketing margins and a lower-than-expected refining margins remains key risk to earnings and valuation.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	2,32,545	3,62,277	6,13,641	6,26,898
OPM (%)	7.6	4.5	-0.1	2.6
Adjusted PAT	13,227	8,866	-3,516	8,920
% YoY growth	251.4	-33.0	NA	NA
Adjusted EPS (Rs.)	63.2	41.6	-16.5	41.9
P/E (x)	5.3	8.1	NA	8.0
P/B (x)	1.3	1.4	1.4	1.4
EV/EBITDA (x)	4.9	5.9	NA	5.8
RoNW (%)	30.1	17.0	NA	17.9
RoCE (%)	26.3	19.2	NA	16.0

Source: Company; Sharekhan estimates

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	35.22
Updated July 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. 72,952 cr
52-week high/low:	Rs. 503/294
NSE volume: (No of shares)	47.6 lakh
BSE code:	500547
NSE code:	BPCL
Free float: (No of shares)	102.0 cr

Shareholding (%)

Promoters	53.0
FII	13.2
DII	20.7
Others	13.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	2.1	-5.8	-9.7	-26.2
Relative to Sensex	-5.7	-12.3	-11.0	-33.8

Sharekhan Research, Bloomberg

Higher-than-expected Q1 net loss on massive loss in marketing and forex/marketing inventory loss

BPCL reported higher-than-expected standalone operating loss of Rs. 5,092 crore in Q1FY23 (versus an operating profit of Rs. 4,249 crore in Q4FY22) due to a larger-than-expected loss (large negative marketing margin on petrol/diesel on non-revision of retail prices) in the marketing business, a huge forex loss of Rs. 965 crore and marketing inventory loss of Rs. 371 crore (versus gain of Rs. 3,177 crore in Q4FY22). This was partially offset by a beat in reported GRM at $27.5/bbl (up 80% q-o-q and versus our estimate of $22/bbl). Volume performance was mixed with refining throughput beat estimates at 9.7 mmt, up 19.3% q-o-q but lower-than-expected marketing sales volume at 12.3 mmt, down 2.6% q-o-q. The company reported a net loss of Rs. 6,291 crore (almost double versus our expectations of a net loss of Rs. 3,138 crore) primarily on losses in marketing business, higher forex/marketing inventory loss and larger-than-expected depreciation (up 26.5% q-o-q).

Results (Standalone) Rs cr

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Revenue	1,21,066	70,923	70.7	1,08,774	11.3
Total Expenditure	1,26,968	67,708	87.5	1,04,524	21.5
Operating profit	**-5,902**	**3,216**	**NA**	**4,249**	**NA**
Other Income	440	450	-2.1	598	-26.3
Interest	616	487	26.5	534	15.3
Depreciation	1,611	1,145	40.7	1,274	26.5
Exceptional income/(expense)	0	1,643	NA	0	NA
Reported PBT	-7,688	3,677	NA	3,040	NA
Adjusted PBT	**-7,688**	**2,034**	**NA**	**3,040**	**NA**
Tax	-1,397	485	NA	909	NA
Reported PAT	-6,291	3,193	NA	2,131	NA
Adjusted PAT	**-6,291**	**1,522**	**NA**	**2,131**	**NA**
Equity Cap (cr)	213	213		213	
Reported EPS (Rs.)	-29.5	15.0	NA	10.0	NA
Adjusted EPS (Rs.)	-29.5	7.1	NA	10.0	NA
Margins(%)			**BPS**		**BPS**
Adjusted OPM	-4.9	4.5	NA	3.9	NA
Adjusted NPM	-5.2	2.1	NA	2.0	NA
Tax rate	18.2	13.2	499.0	29.9	-1,173.5

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
GRM ($/bbl)	27.5	4.1	567.7%	15.3	80.3%
Refining throughput (mmt)	9.7	6.8	41.7%	8.1	19.3%
Market sales (mmt)	12.3	9.9	23.4%	12.6	-2.6%
Marketing inventory gain/(loss) - Rs. crore	-371	815	NA	3,177	NA
Forex gain/(loss) - Rs. crore	-965	-47	NA	-197	NA

Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector view - Near-term muted outlook on weakening GRM and elevated crude oil price**

OMCs' earnings in H1FY23 is expected to remain challenging on two counts – firstly, sustained high crude oil prices and inability to hike retail petrol/diesel would mean a large marketing loss on auto fuels and secondly, refining margins have declined sharply due to lower transportation fuel crack spreads. Moreover, the weakening of the Indian Rupee would add to trouble given a rise in forex losses. However, we believe that both refining and marketing margins would gradually normalise and thus expect a recovery in earnings of OMCs in H2FY23.

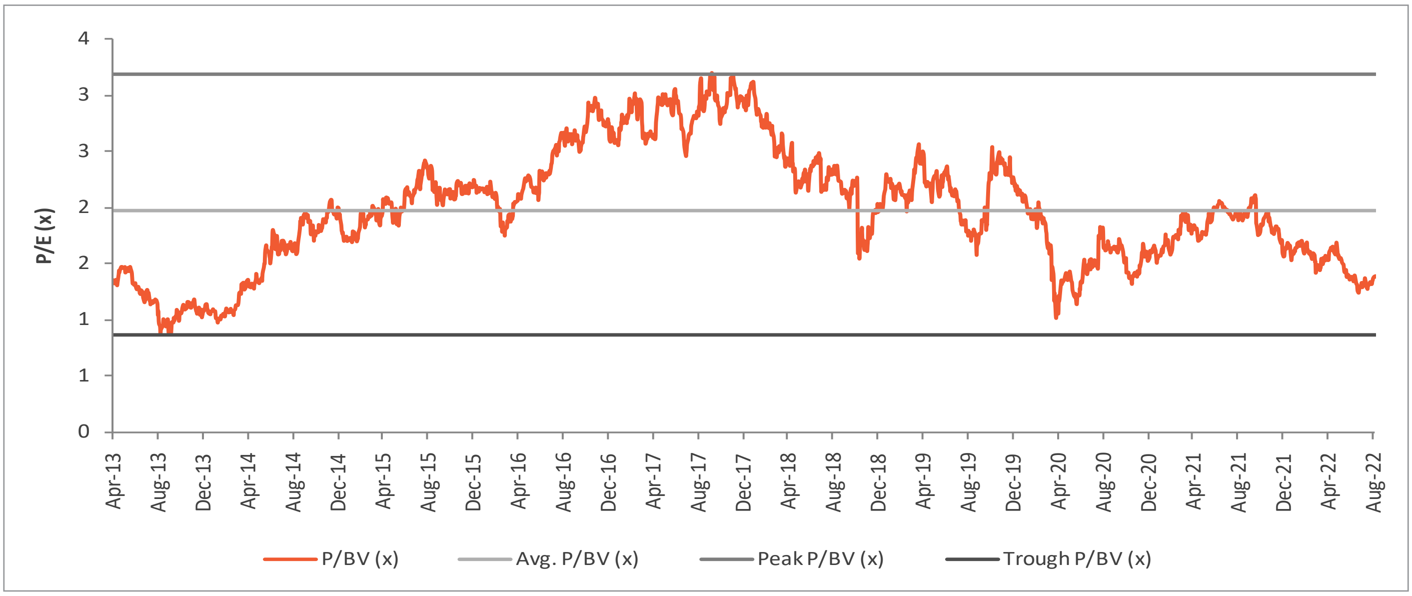
■ **Company outlook - Near-term earnings headwinds; expect a gradual recovery**

We expect BPCL's earnings to remain muted in H1FY23 due to negative marketing margins on motor spirit (MS)/high-speed diesel (HSD) given inadequate price revision amid elevated crude oil prices.. Moreover, refining margins have also weakened recently and may not provide relief against marketing losses. Overall, we expect BPCL to report a standalone net loss of Rs. 3,516 crore in FY23 and recover strongly in FY24 as marketing segment's profitability would normalise gradually. Likely normalisation of international crude oil prices or steep MS/HSD retail price hikes hold the key for an earnings revival of OMCs.

■ **Valuation - Maintain Buy on BPCL with an unchanged PT of Rs. 375**

We believe that H1FY23 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins (led by a recent sharp decline in Brent crude oil price to $95/bbl) would lead to overall earnings recovery. Moreover, BPCL's valuation of 8x its FY2024E EPS and 1.4x its FY2024E P/BV is attractive and FY24E DPS implies a 5% dividend yield. Hence, we maintain a Buy on BPCL with an unchanged PT of 375.

One-year forward P/BV (x) band



Source: Sharekhan Research

About company

BPCL is the second largest 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 27.5 mmt and retail fuel outlets of 18,637. The company also holds 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

BPCL would witness weak profitability and volatile earnings for both marketing and refining business due to high crude oil price and forex loss. Having said that, the company's largely factors in above concerns and earnings would see gradual recovery with normalization of marketing margin. Earnings recovery would mean healthy dividend yield.

Key Risks

- Sustained weak auto fuel marketing margin
- Lower-than-expected refining margins in case of surplus global refining capacity.
- Lower-than-expected marketing volume and refining throughput in case if economic slowdown.

Additional Data

Key management personnel

Arun Kumar Singh	Chairman and Managing Director
Vetsa Ramakrishna Gupta	Director – Finance
Sanjay Khanna	Director –Refineries

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.9
2	ICICI Prudential Asset Management	2.5
3	HDFC Asset Management Co. Ltd.	2.0
4	SBI Funds Management Pvt. Ltd.	1.8
5	Vanguard Group Inc.	1.7
6	BlackRock Inc.	1.2
7	Norges Bank	0.7
8	Franklin Resources Inc.	0.7
9	Mirae Asset Global Investments Company	0.7
10	Kotak Mahindra Asset Management Company Ltd	0.6

Source: Bloomberg (old data)

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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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