Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Hindustan Petroleum Corporation Ltd

Massive Q1 loss on weak marketing; maintain Buy

Oil & Gas	Sharekhan code: HINDPETRO

Reco/View: Buy	↔	CMP: **Rs. 251**	Price Target: **Rs. 290**	↓

↑ 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 July 08, 2022

High Risk

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

Source: Morningstar

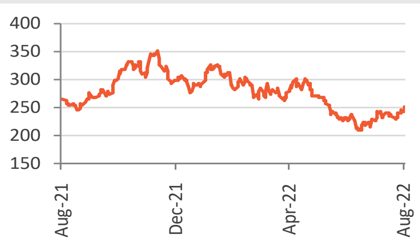
Company details

Market cap:	Rs. 35,563 cr
52-week high/low:	Rs. 355/207
NSE volume: (No of shares)	48.8 lakh
BSE code:	500104
NSE code:	HINDPETRO
Free float: (No of shares)	64.0 cr

Shareholding (%)

Promoters	54.9
FII	18.2
DII	16.4
Others	10.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.5	-6.6	-12.1	-5.4
Relative to Sensex	-5.3	-13.1	-13.5	-13.0

Sharekhan Research, Bloomberg

Summary

- Q1FY23 net loss of Rs. 10,197 crore was much higher than our estimates due to a massive loss in marketing business and miss in refining earnings on lower-than-expected improvement in refining margins.
- Large negative auto fuel marketing margins continued to dent marketing segment's performance; refining segment also disappointed with 21% miss in GRM at $16.7/bbl (under-performed IOCL with a wide margin of $16/bbl).
- 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 margin. This coupled with a recovery in refining margins would help earnings recover over H2FY23-FY24.
- We maintain a Buy on HPCL with a revised PT of Rs. 290 (lowered PT to reflects a cut in P/E multiple, given a sharp fall in refining margins) on in expensive valuation of 3.7x/0.8x FY24E EPS/BV and FY24E dividend yield of 10%.

Hindustan Petroleum Corporation Limited (HPCL) reported higher-than-expected standalone operating loss of Rs. 12,870 crore in Q1FY23 (versus an operating profit of Rs. 1,752 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, lower-than-expected reported GRM of $16.7/bbl (up 34.2% q-o-q but 21% below our estimate of $21/bbl) and a huge forex loss of Rs 945 crore. Volume performance was also mixed with refining throughput/pipeline throughput beat estimates at 4.8 mmt/5.8 mmt, up 2.6%/8.1% q-o-q but a miss kept marketing sales volume at 10.7 mmt, flat q-o-q. The company reported a net loss of Rs. 10,197 crore (almost double versus our expectations of a net loss of Rs. 5,812 crore) primarily on losses in marketing business, miss in GRM and huge forex loss.

Key positives

- Decent recovery in refining/pipeline throughput to 4.8 mmt/5.8 mmt, up 2.6%/8.1% q-o-q. .

Key negatives

- Large negative marketing margin on auto fuels due to non-revision of petrol/diesel prices.
- Sharp miss in the reported GRM at $16.7/bbl (versus estimate of $21/bbl).

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

Our Call

Valuation – Maintain Buy on HPCL with a revised PT of Rs. 290: We believe that H1FY23 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins (led by recent sharp decline in Brent crude oil price to $95/bbl) would lead to overall earnings recovery. Moreover, HPCL's valuation of 3.7x its FY2024E EPS and 0.8x its FY2024E P/BV is attractive and FY24E DPS implies a 10% dividend yield. Hence, we maintain a Buy on HPCL but with a lower PT of 290 (reflects lower P/E multiple given a sharp fall in refining margins).

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	2,31,913	3,48,428	4,17,164	3,73,252
OPM (%)	6.4	2.6	-0.2	4.1
Adjusted PAT	10,664	6,383	-2,075	9,724
% y-o-y growth	409.7	-40.1	NA	NA
Adjusted EPS (Rs.)	75.2	45.0	NA	68.5
P/E (x)	3.3	5.6	NA	3.7
P/B (x)	1.0	0.9	0.9	0.8
EV/EBITDA (x)	4.9	8.3	NA	4.0
RoNW (%)	32.7	17.0	NA	24.0
RoCE (%)	21.7	11.6	NA	17.7

Source: Company; Sharekhan estimates

Higher-than-expected Q1 net loss on marketing loss and miss in GRM

HPCL reported higher-than-expected standalone operating loss of Rs. 12,870 crore in Q1FY23 (versus an operating profit of Rs. 1,752 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, lower-than-expected reported GRM of $16.7/bbl (up 34.2% q-o-q but 21% below our estimate of $21/bbl) and a huge forex loss of Rs 945 crore. Volume performance was also mixed. Refining throughput/pipeline throughput beat estimates at 4.8 mmt/5.8 mmt, up 2.6%/8.1% q-o-q but a miss kept marketing sales volume at 10.7 mmt, flat q-o-q. The company reported a net loss of Rs. 10,197 crore (almost double versus our expectations of a net loss of Rs. 5,812 crore) primarily on losses in marketing business and miss in GRMs.

Results (standalone) — Rs cr

Particulars	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Revenue	1,14,080	72,166	58.1	97,227	17.3
Total Expenditure	1,26,949	69,475	82.7	95,474	33.0
Operating profit	**-12,870**	**2,691**	**NA**	**1,752**	**NA**
Other Income	715	874	-18.2	1,944	-63.2
Interest	333	254	30.9	328	1.3
Depreciation	1094	914	19.8	1083	1.0
PBT	**-13,582**	**2,397**	**NA**	**2,285**	**NA**
Tax	-3385	602	NA	490	NA
Reported PAT	**-10,197**	**1,795**	**NA**	**1,795**	**NA**
Equity Cap (cr)	142	142	0.0	142	0.0
Reported EPS (Rs)	-71.9	12.7	NA	12.7	NA0
Margins(%)			**BPS**		**BPS**
OPM	-11.3	3.7	NA	1.8	NA
NPM	-8.9	2.5	NA	1.8	NA
Tax rate	24.9	25.1	-18.7	21.4	349.2

Source: Company, Sharekhan Research

Key operating metrics

Operating performance	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)
Reported GRM ($/bbl)	16.7	3.3	404.2	12.4	34.2
Refining throughput (mmt)	4.8	2.5	91.6	4.7	2.6
Market sales including exports (mmt)	10.7	8.8	21.2	10.7	0.3
Pipeline throughput (mmt)	5.8	4.3	32.5	5.3	8.1

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 large marketing loss on auto fuels and secondly, refining margins have declined sharply due to lower transportation fuel crack spreads. Moreover, the weakening 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.

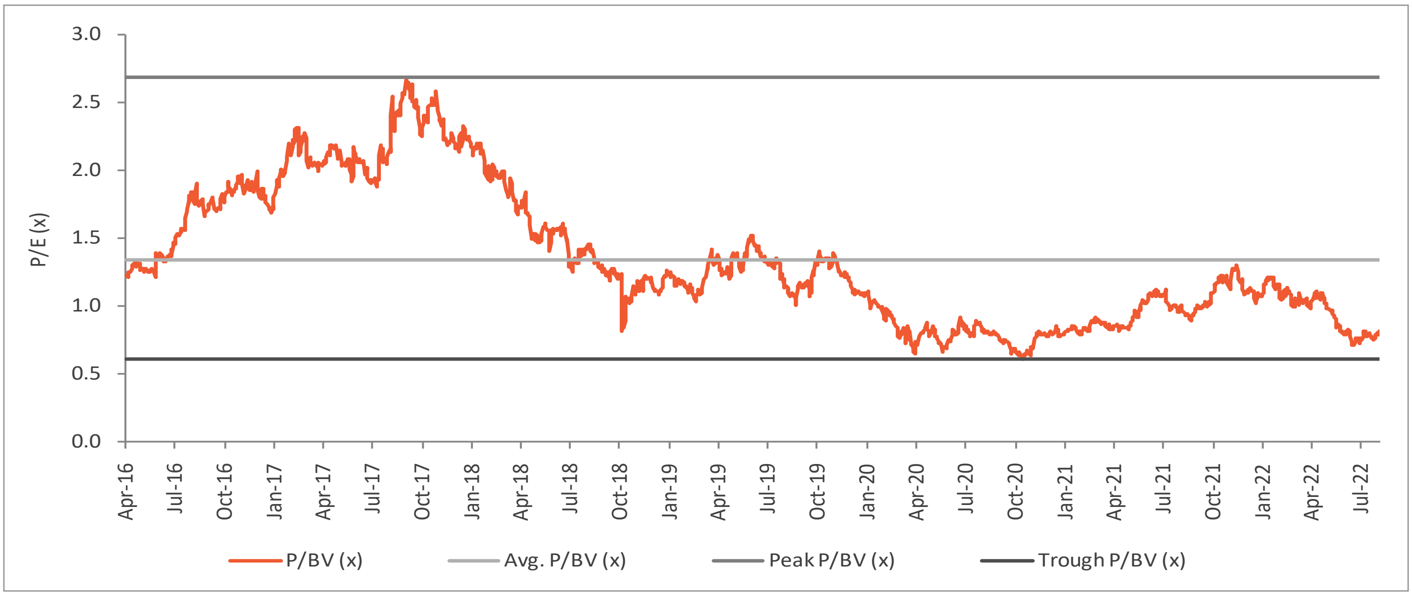
■ Company outlook - Near-term earnings headwinds; expect a gradual recovery

We expect HPCL's earnings to remain muted in H1FY23 due to negative marketing margins from motor spirit (MS)/high-speed diesel (HSD) given inadequate price revision amid elevated crude oil prices and high product cracks. Moreover, refining margins have also weakened recently and may not provide relief against marketing losses. Overall, we expect HPCL to report a standalone net loss of Rs2075 crore in FY23 and recover strongly in FY24 as marketing segment's profitability would normalise gradually. Likely normalization 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 HPCL with a revised PT of Rs. 290

We believe that H1FY23 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins (led by recent sharp decline in Brent crude oil price to $95/bbl) would lead to overall earnings recovery. Moreover, HPCL's valuation of 3.7x its FY2024E EPS and 0.8x its FY2024E P/BV is attractive and FY24E DPS implies a 10% dividend yield. Hence, we maintain a Buy on HPCL but with a lower PT of 290 (reflects lower P/E multiple given a sharp fall in refining margins).

One-year forward P/BV (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 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 high dividend yield.

Key Risks

- Lower-than-expected refining and marketing margins could affect earnings outlook.
- Lower-than-expected volume in case of economic slowdown.
- 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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