Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Hindustan Petroleum Corporation Ltd

Another weak quarter

Oil & Gas	Sharekhan code: HINDPETRO

Reco/View: Buy	↔	CMP: **Rs. 204**	Price Target: **Rs. 250**	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q2FY23 reported a net loss of Rs. 2,172 crore (versus loss of Rs. 10,197 crore in Q1FY23) was much lower than our estimate on account of one-off LPG subsidy of Rs. 5,617 crore and better-than-expected GRM of $8.4/bbl. Adjusting for LPG subsidies, the net loss was high at Rs. 6,389 crore (versus our estimate of a net loss of Rs. 6,034 crore).
- Weak performance reflects continued large losses in marketing business due to negative diesel margins and 6.7%/2.9%/3.8% q-o-q decline in refinery throughput/marketing volume/ pipeline throughput of 4.5 mmt/10.4 mmt/5.5 mmt in Q2FY23.
- We believe that H1FY23 factors in the worst for OMCs and the gradual petrol/diesel prices hikes coupled with likely normalisation of refining margins would drive earnings recovery in H2FY23-FY24.
- We maintain a Buy on HPCL with a revised PT of Rs. 250 (lowered PT to reflects a cut in P/E multiple given volatile earnings environment) on inexpensive valuations of 3x/0.7x FY24E EPS/BV and FY24E dividend yield of 10-11%.

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

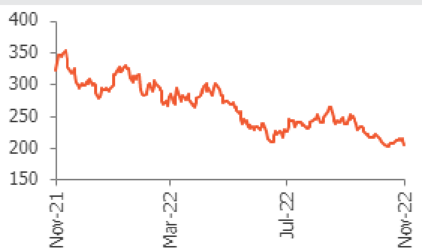
Company details

Market cap:	Rs. 28,889 cr
52-week high/low:	Rs. 355/200
NSE volume: (No of shares)	43.1 lakh
BSE code:	500104
NSE code:	HINDPETRO
Free float: (No of shares)	64.0 cr

Shareholding (%)

Promoters	54.9
FII	16.7
DII	18.0
Others	10.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7	-17	-25	-37
Relative to Sensex	-12	-21	-35	-38

Sharekhan Research, Bloomberg

Hindustan Petroleum Corporation Limited's (HPCL) standalone reported operating loss of Rs. 1,859 crore (versus loss Rs. 12,870 crore in Q1FY23) was substantially lower than our estimate of Rs. 7,113 crore. The positive surprise was driven by a compensation of Rs. 5,617 crore from the government related to LPG under-recoveries for FY22 and H1FY23 and higher-than-expected GRM of $8.4/bbl (versus $2.4/$16.7 per bbl in Q2FY22/ Q1FY23). Volume performance was below expectation with refinery throughput/ marketing volume/pipeline throughput of 4.5 mmt/10.4 mmt/5.5, down 6.7%/2.9%/3.8% q-o-q. Reported net loss came in at Rs. 2,172 crore (versus net loss of Rs. 10,197 crore in Q1FY23). Adjusting for LPG subsidy, net loss stood at Rs. 6,389 crore was largely in-line with our estimate of Rs. 6,034 crore and reflects loss in marketing business on account of negative diesel marketing margin and some impact of export tax on transportation fuels.

Key positives

- LPG subsidy of Rs. 5,617 crore received for FY22 and H1FY23.
- Better-than-expected GRM of $8.4/bbl.

Key negatives

- Continued loss in the marketing business due to negative marketing margin on diesel.
- Standalone gross debt increased sharply by 59% y-o-y to Rs. 68,546 crore.

Revision in estimates - We now estimate higher net loss for FY23 as we factor continued negative diesel marketing and lower GRM. We have fine tune our FY24 earnings estimate and introduced our FY25 earnings estimate.

Our Call

Valuation – Maintain Buy on HPCL with a revised PT of Rs. 250: We believe that H1FY23 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins would lead to overall earnings recovery. Moreover, HPCL's valuation of 3x its FY2024E EPS and 0.7x 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 Rs. 250 (reflects a lower P/E multiple given volatile earnings environment).

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	3,48,428	4,17,164	3,73,252	3,51,296
OPM (%)	2.6	-3.6	4.1	4.5
Adjusted PAT	6,383	-8,610	9,785	10,239
% y-o-y growth	-40.1	NM	NM	4.6
Adjusted EPS (Rs.)	45.0	-60.7	69.0	72.2
P/E (x)	4.5	NM	3.0	2.8
P/B (x)	0.7	0.9	0.7	0.6
EV/EBITDA (x)	7.5	NM	3.8	3.4
RoNW (%)	17.0	NM	26.6	24.0
RoCE (%)	11.6	NM	17.8	18.3

Source: Company; Sharekhan estimates

Weak Q2; lower-than-expected reported net loss supported by one-time LPG subsidy

Q2FY23 standalone reported operating loss of Rs. 1,859 crore (versus loss Rs. 12,870 crore in Q1FY23) was substantially lower than our estimate of Rs. 7,113 crore. The positive surprise was driven by a compensation of Rs. 5,617 crore from the government related to LPG under-recoveries for FY22 and H1FY23 and higher-than-expected GRM of $8.4/bbl (versus $2.4/$16.7 per bbl in Q2FY22/Q1FY23). Volume performance was below expectation with refinery throughput/marketing volume/pipeline throughput of 4.5 mmt/10.4 mmt/5.5, down 6.7%/2.9%/3.8% q-o-q. Reported net loss came in at Rs. 2,172 crore (versus net loss of Rs. 10,197 crore in Q1FY23). Adjusting for LPG subsidy, net loss stood at Rs. 6,389 crore was largely in-line with our estimate of Rs. 6,034 crore and reflects loss in marketing business on account of negative diesel marketing margin and some impact of export tax on transportation fuels.

Results (standalone) Rs cr

Particulars	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Revenue	**1,08,056**	**82,775**	**30.5**	**1,14,080**	**-5.3**
Total Expenditure	1,09,915	80,051	37.3	1,26,949	-13.4
Reported operating profit	-1,859	2,724	NA	-12,870	NA
Adjusted operating profit	**-7,476**	**2,724**	**NA**	**-12,870**	**NA**
Other Income	642	739	-13.2	715	-10.2
EBITDA	-1,217	3,463	NA	-12,155	NA
Interest	595	154	285.2	333	78.8
Depreciation	1081	947	14.1	1094	-1.2
Exceptional income/(expense)	0	0		0	
Reported PBT	-2,893	2,361	NA	-13,582	NA
Adjusted PBT	**-8,510**	**2,361**	**NA**	**-13,582**	**NA**
Tax	-721	438	NA	-3385	NA
Reported PAT	-2,172	1,924	NA	-10,197	NA
Adjusted PAT	**-6,389**	**1,924**	**NA**	**-10,197**	**NA**
Equity Cap (cr)	142	142		142	
Reported EPS (Rs.)	-15.3	13.6	NA	-71.9	NA
Adjusted EPS (Rs.)	-45.0	13.6	NA	-71.9	NA
Margins (%)			**BPS**		**BPS**
Adjusted OPM	-1.7	3.3	NA	-11.3	NA
Adjusted NPM	-2.0	2.3	NA	-8.9	NA
Tax rate	24.9	18.5	638.5	24.9	0.0

Source: Company, Sharekhan Research

Key operating metrics Rs cr

Operating performance	Q2FY23	Q2FY22	YoY (%)	Q1FY23	QoQ (%)
Reported GRM ($/bbl)	8.4	2.4	244.7	16.7	-49.6
Refining throughput (mmt)	4.5	2.5	77.5	4.8	-6.7
Market sales including exports (mmt)	10.4	9.1	14.2	10.7	-2.9
Pipeline throughput (mmt)	5.5	4.8	16.4	5.8	-3.8

Source: Company, Sharekhan Research

Outlook and Valuation

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

OMCs' earnings remained stressed in H1FY23 on two counts – first, sustained high crude oil prices and inability to hike retail petrol/diesel would mean large marketing loss on auto fuels and second, 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 over H2FY23-FY24.

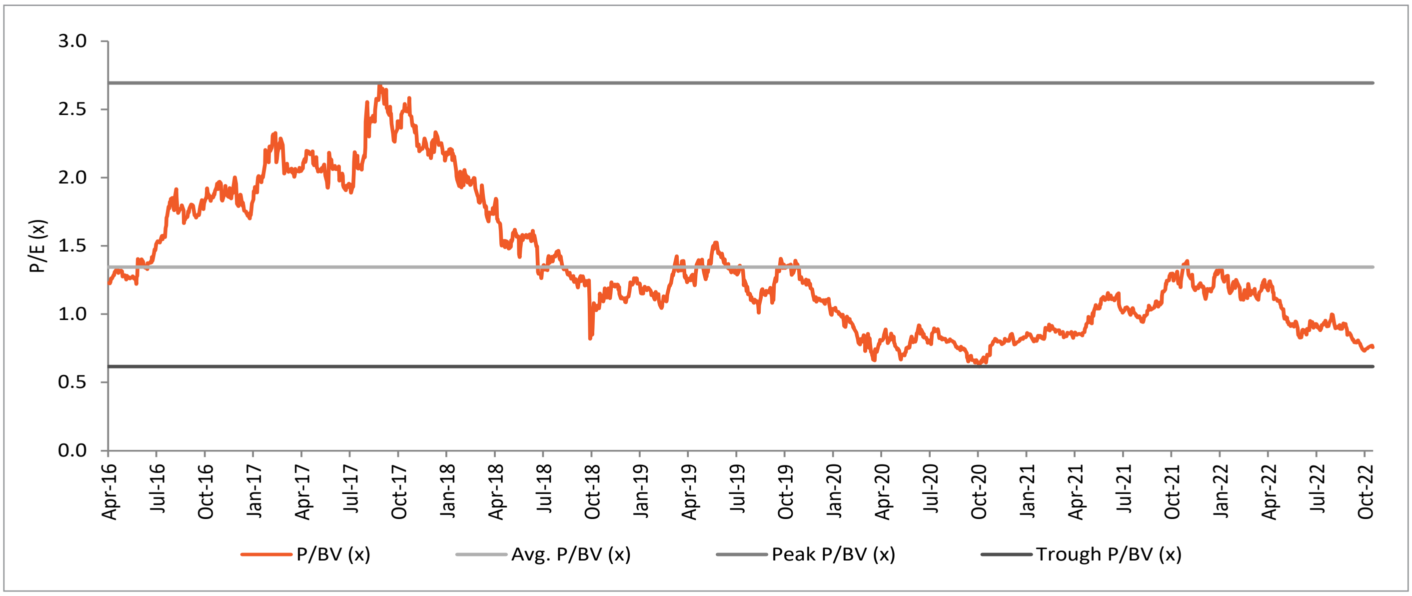
■ Company outlook - Near-term earnings headwinds; expect a gradual recovery

HJPCL's earnings remained muted in H1FY23 due to negative marketing margins on motor spirit (MS)/high-speed diesel (HSD) given inadequate price revision amid elevated crude oil price and high products cracks. Moreover, refining margins has been also volatile and may not provide relief against marketing losses. Overall, we expect HPCL to report a standalone net loss of Rs. 8,610 crore in FY23 and recover strongly in FY24 as marketing segment's profitability would normalise gradually. Likely normalisation of international crude oil prices, steep MS/HSD retail price hikes hold the key for an earnings revival of OMCs. Any kind of compensation from the government on loss in auto fuels could reduce losses although probability of the same seems low given both diesel/petrol are deregulated petroleum products and government's fiscal constraint.

■ Valuation - Maintain Buy on HPCL with a revised PT of Rs. 250

We believe that H1FY23 would factor in the worst for OMCs and a gradual normalisation of refining & marketing margins would lead to overall earnings recovery. Moreover, HPCL's valuation of 3x its FY2024E EPS and 0.7x 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 Rs. 250 (reflects a lower P/E multiple given volatile earnings environment).

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 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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