Stock Update

Result Update

Bharat Petroleum Corporation Ltd

Robust Q3 led by beat in refining performance

Oil & Gas	Sharekhan code: BPCL
Reco/View: Buy ↔	CMP: Rs. 343	Price Target: Rs. 400 ↑

↑ 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 36.68

Updated Dec 08, 2022

High Risk

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

Source: Morningstar

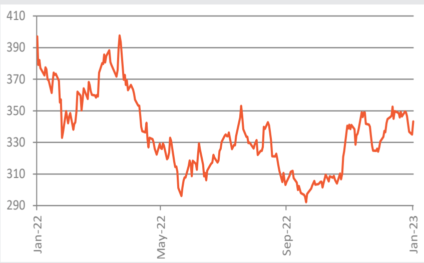
Company details

Market cap:	Rs. 74,460 cr
52-week high/low:	Rs. 400/288
NSE volume: (No of shares)	33.6 lakh
BSE code:	500547
NSE code:	BPCL
Free float: (No of shares)	102.0 cr

Shareholding (%)

Promoters	53.0
FII	12.5
DII	21.8
Others	12.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.8	13.1	3.9	(13.5)
Relative to Sensex	6.0	15.0	0.5	(16.2)

Sharekhan Research, Bloomberg

Summary

- Q3FY2023 standalone PAT of Rs. 1,960 crore was significantly above our estimate, led by a sharp beat in GRMs at $15.9/bbl, higher-than-expected volumes, and lower tax rate, partially offset by increased interest cost and lower other income.
- Derived gross marketing margin was positive at Rs. 1,516/tonne (versus negative Rs. 459/tonne in Q2FY2023) despite inventory/forex loss of Rs. 752 crore/Rs. 141 crore. Refinery throughput/marketing sales volume was up 6.5%/11.4% q-o-q to 9.4mmt/13mmt in Q3FY2023. Debt declined by 25% q-o-q to Rs. 40,256 crore in Q3FY2023.
- We believe the earnings downgrade cycle is largely over for OMCs and expect earnings to normalise over FY2024-FY2025, led by strength in GRM and likely normalised auto fuel marketing margins. Any spike in crude oil price is key risk to earnings recovery, especially given the inability of OMCs to hike petrol/diesel price in an inflationary environment.
- We maintain Buy on BPCL with and a revised PT of Rs. 400, given attractive valuation of 8.1x/1.4x its FY2024E EPS/BV and FY2024E dividend yield of ~5%.

Q3FY2023 standalone operating profit of Rs. 4,234 crore (versus loss of Rs. 4,148 crore in Q2FY2023) was 36%/10% above our/street estimate of Rs. 3,112 crore/Rs. 3,854 crore. The beat was driven by strong refining segment performance with reported GRM of $15.9/bbl (27% above our estimate of $12.5/bbl) and refining throughput of 9.4mmt (up 6.5% q-o-q and 4% above estimate). Gross marketing margin (based on our backward calculation) was positive at Rs. 1,516/tonne versus negative Rs. 459/tonne in Q2FY2023. Marketing sales volume stood at 13mmt (up 11.3%/11.4% y-o-y/q-o-q). Adjusted for inventory/forex loss of Rs. 752 crore/Rs. 141 crore, gross marketing margin was at Rs. 2,202/tonne (versus Rs. 372/tonne in Q2FY2023). PAT at Rs. 1,960 crore (versus adjusted net loss of Rs. 4,823 crore in Q2FY23) was 85%/36% above our/street estimate, led by robust refining performance and lower tax rate, partially offset by higher interest cost and lower other income.

Key positives

- Sharp beat in reported GRM at $15.9/bbl, 27% above our estimate of $12.5/bbl and premium of $9.7/bbl over Singapore complex GRM.
- Strong refinery throughput of 9.4mmt, up 11.4% q-o-q.

Key negatives

- Marginally higher-than-expected inventory loss of Rs. 752 crore (versus Rs. 384 crore in Q2FY2023).

Revision in estimates – We have lowered our net loss estimate for FY2023 to factor in strong Q3FY2023 performance and positive auto fuel marketing margin in Q4FY2023. We have fine-tuned our FY2024-FY2025 earnings estimate. Our FY2022-FY2025E earnings now factor in the merger of BORL and BGRL with BPCL.

Our Call

Valuation – Maintain Buy on BPCL with a revised PT of Rs. 400: We believe the earnings downgrade cycle is largely over for OMCs and continued strength in GRM (supported by high middle distillate cracks) with likely normalised auto fuel marketing margins would lead to normalised earnings over FY2024-FY2025. Moreover, BPCL's valuation of 8.1x its FY2024E EPS and 1.4x its FY2024E P/BV is attractive and FY2024E DPS implies a 5% dividend yield. Hence, we maintain Buy on BPCL with a revised price target (PT) of Rs. 400.

Key Risks

Sustained weak auto fuel marketing margin in case of continued inability to raise petrol/diesel price and lower-than-expected refining margins remain key risks to earnings and valuation.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	3,46,644	4,52,643	4,17,448	4,16,447
OPM (%)	5.5	1.1	4.3	4.5
Adjusted PAT	9,720	-2,334	9,023	9,215
% YoY growth	-26.5	-124.0	-486.5	2.1
Adjusted EPS (Rs.)	45.6	-11.0	42.4	43.3
P/E (x)	7.5	-31.3	8.1	7.9
P/B (x)	1.4	1.4	1.4	1.3
EV/EBITDA (x)	5.6	24.4	6.9	6.9
RoNW (%)	18.3	-4.5	17.3	17.2
RoCE (%)	20.4	0.6	15.3	15.0

Source: Company; Sharekhan estimates

Strong Q3; Refining performance drives earnings beat

Q3FY2023 standalone operating profit of Rs. 4,234 crore (versus loss of Rs. 4148 crore in Q2FY2023) was 36%/10% above our/street estimate of Rs. 3,112 crore/Rs. 3,854 crore. The beat was driven by strong performance by the refining segment with reported GRM of $15.9/bbl (27% above estimate of $12.5/bbl) and refining throughput of 9.4mmt (up 6.5% q-o-q and 4% above estimate). Gross marketing margin (based on our backward calculation) was positive at Rs. 1,516/tonne versus negative Rs. 459/tonne in Q2FY2023. Marketing sales volume stood at 13mmt (up 11.3%/11.4% y-o-y/q-o-q). Adjusted for inventory/forex loss of Rs. 752 crore/ Rs. 141 crore, marketing gross was at Rs. 2,202/tonne (versus Rs. 372/tonne in Q2FY2023). PAT at Rs. 1,960 crore (versus net loss of Rs. 4,823 crore in Q2FY2023) was 85%/36% above our/street estimate, led by robust refining performance and lower tax rate, partially offset by higher interest cost and lower other income.

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	**1,19,158**	**95,086**	**25.3**	**1,14,808**	**3.8**
Total Expenditure	1,14,924	90,030	27.7	1,13,374	1.4
Reported operating profit	4,234	5,057	-16.3	1,434	195.3
Adjusted operating profit	**4,234**	**5,057**	**-16.3**	**-4,148**	**NA**
Other Income	452	704	-35.8	557	-18.9
Interest	978	565	73.2	811	20.7
Depreciation	1,582	1,389	13.9	1,557	1.6
Reported PBT	2,126	3,807	-44.2	-376	NA
Adjusted PBT	**2,126**	**3,807**	**-44.2**	**-5,958**	**NA**
Tax	166	978	-83.0	-72	NA
Reported PAT	1,960	2,828	-30.7	-304	NA
Adjusted PAT	**1,960**	**2,828**	**-30.7**	**-4,823**	**NA**
Equity Cap (cr)	213	213		213	
Reported EPS (Rs.)	9.2	13.3	-30.7	-1.4	NA
Adjusted EPS (Rs.)	9.2	13.3	-30.7	-22.6	NA
Margins (%)			**BPS**		**BPS**
Adjusted OPM	3.6	5.3	-176.5	-3.6	NA
Adjusted NPM	1.6	3.0	-133.0	-4.2	NA
Tax rate	7.8	25.7	-1787.4	19.1	-1,123.1

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
GRM ($/bbl)	15.9	9.7	64.3%	16.8	-5.2%
Refining throughput (mmt)	9.4	9.9	-5.5%	8.8	6.5%
Market sales (mmt)	13.0	11.7	11.3%	11.7	11.4%
Marketing inventory gain/(loss) – Rs. crore	-752	-1,423	NA	-384	NA
Forex gain/(loss) - Rs crore	-141	-6	NA	-587	NA

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Improving outlook but inability to hike petrol and diesel prices a concern for OMCs

OMCs' earnings remained stressed in H1FY2023 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, weakening Indian Rupee would add to trouble, given a rise in forex losses. OMCs' inability to hike petrol and diesel prices also remains a concern. However, we believe the recent decline in Brent crude price and likely resilient refining and normalisation of marketing margins would gradually normalise. Thus, we expect recovery in earnings of OMCs over FY2024-FY2025.

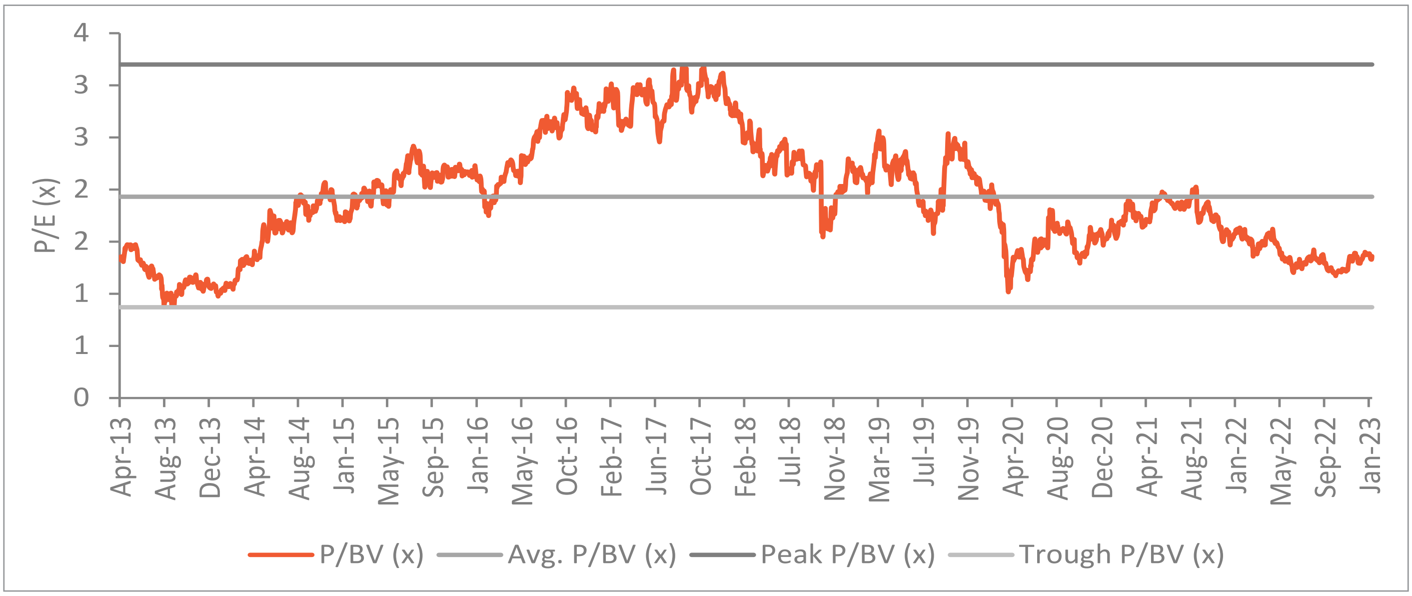
■ Company Outlook – Expect gradual earnings recovery

Post steel loss in H1FY2023, BPCL's Q3FY2023 earnings performance provides signs of a gradual earnings recovery if crude oil price follows the stable-to-declining trend. We believe core earnings of BPCL to largely normalise over FY2024-FY2025, supported by encouraging trends in refining (Singapore GRM at $10-11/bbl in January 2023) and marketing margin (declining auto fuel under-recoveries and expectation of positive auto fuel marketing margin from Q4FY2023). Likely normalisation of international crude oil prices and stability in GRM hold the key for an earnings revival of OMCs. Any kind of compensation from the government on loss in auto fuels could reduce FY2023 losses of OMCs, although the probability of the same seems low given both diesel/petrol are deregulated petroleum products and the government's fiscal constraint.

■ Valuation – Maintain Buy on BPCL with a revised PT of Rs. 400

We believe the earnings downgrade cycle is largely over for OMCs and continued strength in GRM (supported by high middle distillate cracks) with likely normalised auto fuel marketing margins would lead to normalised earnings over FY2024-FY2025. Moreover, BPCL's valuation of 8.1x its FY2024E EPS and 1.4x its FY2024E P/BV is attractive and FY2024E DPS implies a 5% dividend yield. Hence, we maintain Buy on BPCL with a revised PT of Rs. 400.

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

OMCs are expected to benefit from the recent recovery in refining margin supported by elevated diesel cracks. Likely normalisation of diesel marketing margin given the recent fall in crude oil price and stability in GRM bodes well for gradual normalization of earnings over FY2024-FY2025. BPCL's valuation is attractive, and the stock offers a 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 of 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	9.1
2	ICICI Prudential Asset Management	2.3
3	HDFC Asset Management Co Ltd	2.2
4	Vanguard Group Inc/The	1.8
5	SBI Funds Management Ltd	1.8
6	BlackRock Inc	1.4
7	UTI Asset Management Co Ltd	0.5
8	ICICI Prudential Life Insurance Co	0.5
9	Lazard Ltd	0.4
10	Kotak Mahindra Asset Management Co	0.4

Source: Bloomberg

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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