Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Hindustan Petroleum Corporation Ltd

Q3 beat led by strong marketing performance

Oil & Gas	Sharekhan code: HINDPETRO
Reco/View: Buy ↔	CMP: **Rs. 233**
Price Target: **Rs. 265** ↑	

↑ 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 38.76

Updated Dec 08, 2022

High Risk

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

Source: Morningstar

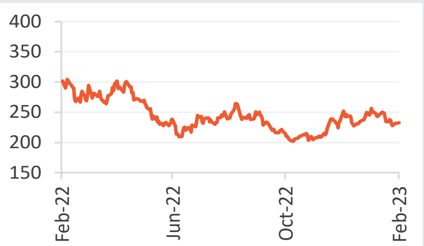
Company details

Market cap:	Rs. 33,017 cr
52-week high/low:	Rs. 307/200
NSE volume: (No of shares)	37.7 lakh
BSE code:	500104
NSE code:	HINDPETRO
Free float: (No of shares)	64.0 cr

Shareholding (%)

Promoters	54.9
FII	15.7
DII	19.6
Others	9.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.2	12.1	-3.1	-22.8
Relative to Sensex	-10.2	13.9	-5.3	-27.2

Sharekhan Research, Bloomberg

Summary

- Q3FY23 PAT of Rs. 172 crore surprised positively, beating our estimate of a net loss of Rs. 427 crore. This was largely led by strong gross marketing margin as GRM of $9.1/bbl was below our estimate of $11/bbl.
- Blended derived gross marketing margins surged 214% q-o-q to Rs. 2,664/tonne; GRM of $9.1/bbl lagged that of BPCL/IOCL at $15.9/$12.9 per barrel. Refinery/pipeline throughput beat estimate at 4.8 mmt/5.8 mmt, up 7.6%/5.6% q-o-q while marketing sales volume of 11.3 mmt (up 8.3% q-o-q) was below our estimate of 11.8 mmt
- We believe that the earnings downgrade cycle is largely over for OMCs and expect earnings to normalise over FY24-25 led by strength in GRM and likely normalised auto fuel marketing margins. A spike in crude oil prices is a key risk to earnings recovery especially given OMCs inability to hike petrol/diesel price in an inflationary environment.
- We maintain a Buy on HPCL with a revised PT of Rs. 265 given inexpensive valuations of 3.4x/0.8x FY24E EPS/BV and FY24E dividend yield of ~10%.

Hindustan Petroleum Corporation Limited's (HPCL) Q3FY23 standalone operating profit of Rs. 1,290 crore (versus loss of Rs. 1859 crore in Q2FY23) substantially beat our estimate of Rs. 629 crore led by better-than-expected blended derived gross marketing margin of Rs. 2,664/tonne (up 214% q-o-q). This could be attributed to over-recovery on petrol margins as well as a lower inventory loss and lower-than-expected forex loss of Rs. 403 crore, which offset the miss in reported GRM of $9.1/bbl (versus estimate of $11/bbl). We highlight here that HPCL underperformed peers in terms of refining performance with GRM of $9.1/bbl versus $15.9/$12.9 per bbl for BPCL/IOCL. Volume performance was mixed with 3%/6% beat in refinery/pipeline throughput at 4.8 mmt/5.8 mmt, up 7.6%/5.6% q-o-q while marketing sales volume of 11.3 mmt (up 8.3% q-o-q) was 4% below our estimate of 11.8 mmt. Reported PAT came in at Rs. 172 crore versus a net loss estimate of Rs. 427 crore, reflecting a better-than-expected performance of marketing business, higher-than-expected other income and benefit of tax provision reversal of Rs. 46 crore for earlier years partially offset by higher interest cost.

Key positives

- Higher-than-expected improvement in derived marketing margins.
- Beat in refinery/pipeline throughput at 4.8 mmt/5.8 mmt, up 7.6%/5.6% q-o-q.

Key negatives

- GRM of $9.1/bbl lagged our estimate and GRM of $15.9/$12.9 per bbl for BPCL/IOCL.

Revision in estimates – We now estimate lower net loss for FY23 given expectation of recovery in marketing margin. We have largely maintained our FY24-25 earnings estimate.

Our Call

Valuation – Maintain Buy on HPCL with a revised PT of Rs. 265: We believe that earnings downgrade cycle is largely over for OMCs and continued strength in GRM (supported by high middle distillate cracks) with likely normalisation of auto fuel marketing margins would stabilise earnings over FY24-25. Moreover, HPCL's valuation of 3.4x 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 with a revised PT of Rs. 265.

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 a key risk to earnings and valuation.

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	-2.9	4.1	4.5
Adjusted PAT	6,383	-6,335	9,785	10,239
% y-o-y growth	-40.1	NA	NA	4.6
Adjusted EPS (Rs.)	45.0	-44.7	69.0	72.2
P/E (x)	5.2	NA	3.4	3.2
P/B (x)	0.8	0.9	0.8	0.7
EV/EBITDA (x)	8.0	NA	4.0	3.5
RoNW (%)	17.0	NA	25.7	23.3
RoCE (%)	11.6	NA	17.8	18.3

Source: Company; Sharekhan estimates

Q3 earnings above estimate on stronger-than-expected recovery in marketing margin; GRM disappoints

Q3FY23 standalone operating profit of Rs. 1,290 crore (versus loss of Rs. 1859 crore in Q2FY23) substantially beat our estimate of Rs. 629 crore led by better-than-expected derived gross marketing margin of Rs. 2,664/tonne (up 214% q-o-q). This could be attributed to over-recovery on petrol margins as well as a lower inventory loss and lower-than-expected forex loss of Rs. 403 crore, which offset the miss in reported GRM of $9.1/bbl (versus estimate of $11/bbl). We highlight here that HPCL underperformed peers in terms of refining performance with GRM of $9.1/bbl versus $15.9/$12.9 per bbl for BPCL/IOCL. Volume performance was mixed with 3%/6% beat in refinery/pipeline throughput at 4.8 mmt/5.8 mmt, up 7.6%/5.6% q-o-q while marketing sales volume of 11.3 mmt (up 8.3% q-o-q) was 4% below our estimate of 11.8 mmt. Reported PAT came in at Rs. 172 crore versus a net loss estimate of Rs. 427 crore, reflecting a better-than-expected performance of marketing business, higher-than-expected other income and benefit of tax provision reversal of Rs. 46 crore for earlier years partially offset by higher interest cost.

Results (standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	**1,09,222**	**96,260**	**13.5**	**1,08,056**	**1.1**
Total Expenditure	1,07,932	94,732	13.9	1,09,915	-1.8
Reported operating profit	1,290	1,529	-15.6	-1,859	NA
Adjusted operating profit	**1,290**	**1,529**	**-15.6**	**-7,476**	**NA**
Other Income	670	893	-24.9	642	4.5
Interest	682	236	189.1	595	14.6
Depreciation	1110	1025	8.4	1081	2.7
Reported PBT	168	1,161	-85.5	-2,893	NA
Adjusted PBT	**168**	**1,161**	**-85.5**	**-8,510**	**NA**
Tax	-4	292	NA	-721	NA
Reported PAT	172	869	-80.2	-2,172	NA
Adjusted PAT	**172**	**869**	**-80.2**	**-6,389**	**NA**
Equity Cap (cr)	142	142		142	
Reported EPS (Rs.)	1.2	6.1	-80.2	-15.3	NA
Adjusted EPS (Rs.)	1.2	6.1	-80.2	-45.0	NA
Margins (%)			**BPS**		**BPS**
Adjusted OPM	1.2	1.6	-40.7	-1.7	NA
Adjusted NPM	0.2	0.9	-74.5	-2.0	NA
Tax rate	-2.4	25.1	NA	24.9	NA

Source: Company, Sharekhan Research

Key operating metrics

Operating performance	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Reported GRM ($/bbl)	9.1	6.4	43.0	8.4	8.7
Refining throughput (mmt)	4.8	4.2	13.9	4.5	7.6
Market sales including exports (mmt)	11.3	10.5	6.7	10.4	8.3
Pipeline throughput (mmt)	5.8	5.5	6.2	5.5	5.6

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 H1FY23 on two counts – first, sustained high crude oil prices and an inability to hike retail petrol/diesel prices that would mean large marketing losses 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. OMCs' inability to hike petrol and diesel prices also a remains a concern. However, we believe that recent decline in the Brent crude price, a likely resilient refining and normalization of marketing margins would gradually normalise and thus expect a recovery in earnings of OMCs over FY24-FY25.

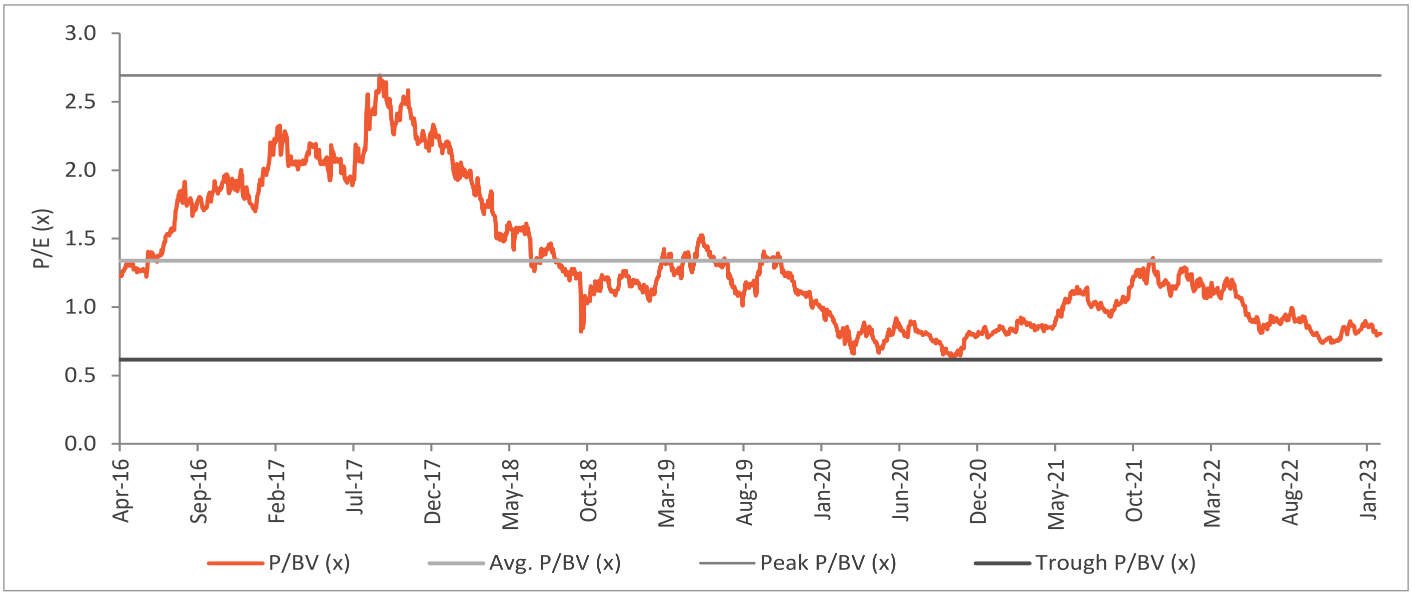
■ Company outlook - Expect gradual earnings recovery

Post steep loss in H1FY23, HPCL's Q3FY23 earnings performance provides signs of a gradual earnings recovery if crude oil prices remain in a stable-to-declining trend. We believe that core earnings of HPCL to largely normalize from over FY24-25 supported by encouraging trends in refining (Singapore GRM at $10-11/bbl in January 2023)) and marketing margins (declining auto fuel under-recoveries and expectation of positive auto fuel marketing margin from Q4FY23). Likely normalisation of international crude oil prices and stable GRMs hold the key for an earnings revival for OMCs. Any kind of compensation from the government on loss in auto fuels could reduce FY23 losses of OMCs 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. 265

We believe that earnings downgrade cycle is largely over for OMCs and continued strength in GRM (supported by high middle distillate cracks) with likely normalisation of auto fuel marketing margins would stabilise earnings over FY24-25. Moreover, HPCL's valuation of 3.4x 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 with a revised PT of Rs. 265.

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

OMCs are expected to benefit from the recent recovery in refining margin supported by elevated diesel cracks. Likely normalization of diesel marketing margin given recent fall in crude oil price and stability in GRM to bodes well gradual normalization of earnings over FY24-25. HPCL's valuation is attractive, and the stock offers high 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

Pushp Kumar Joshi	Chairman & Managing Director
Rajneesh Narang	Director – Finance
S. Bharathan	Director – Refineries
Amit Garg	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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