Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 38.97

Updated Mar 08, 2023

High Risk

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

Source: Morningstar

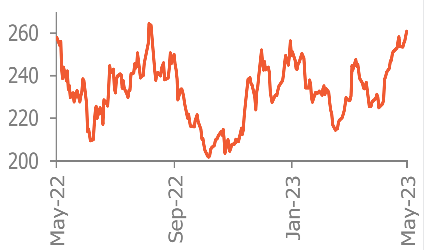
Company details

Market cap:	Rs. 37,003 cr
52-week high/low:	Rs. 267/200
NSE volume: (No of shares)	37.6 lakh
BSE code:	500104
NSE code:	HINDPETRO
Free float: (No of shares)	64.0 cr

Shareholding (%)

Promoters	54.9
FII	14.4
DII	21.4
Others	9.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16	11	24	1
Relative to Sensex	13	10	24	(16)

Sharekhan Research, Bloomberg

Hindustan Petroleum Corporation Ltd

Robust Q4 led by strong GRM & marketing margin

Oil & Gas	Sharekhan code: HINDPETRO

Reco/View: Buy ↔	CMP: Rs. 261	Price Target: Rs. 300 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q4FY23 performance was strong as PAT of Rs. 3,223 crore (versus only Rs. 172 crore in Q3FY23) was 87% above street estimate reflecting sharp recovery in marketing margin, continued strong GRM, higher other income and lower depreciation/interest cost.
- Blended derived gross marketing margins rose 65% q-o-q to Rs. 4,406/tonne led by positive petrol/diesel margin supported by fall in crude oil price. GRM was robust at $14/bbl (up 53% q-o-q) and above estimates of $10/bbl. Volumes were impressive with a 3%/7%/11% beat in refinery throughput/marketing volume/pipeline throughput at 5 mmt/11 mmt/6 mmt.
- HPCL is hiving off entire green & emerging business into a separate subsidiary and exploring options to carve out high margin lubricants business to unlock value going forward. We expect earnings to normalise over FY24-25 led by normalisation of crude oil price. However, a spike in crude oil prices (from $74/bbl currently) is a key risk to earnings recovery especially given OMCs inability to hike petrol/diesel price given general election expected to be scheduled in May 2024.
- We maintain a Buy on HPCL with a revised PT of Rs. 300 (rollover to FY25E EPS) given attractive valuation of 3.8x/1x FY25E EPS/BV and FY24E dividend yield of ~9%.

Hindustan Petroleum Corporation Limited's (HPCL) Q4FY23 standalone operating profit of Rs. 4,407 crore (up 2.5x y-o-y; up 3.4x q-o-q) was 18% above consensus estimate of Rs. 3,731 crore but 9% below our estimate of Rs. 4,831 crore. A sharp beat in operating profit versus consensus estimate was driven by a strong recovery in gross marketing margin Rs. 4,406/tonne (up 65% q-o-q) and higher-than-expected GRM of $14/bbl (up 53% q-o-q and versus estimate of $10-11/bbl). Volume performance was strong with 3%/7%/11% beat in refinery throughput/marketing volume/pipeline throughput at 5 mmt/11 mmt/6 mmt, up/down/up 2.7%/1.2%/5% q-o-q. Reported standalone PAT of Rs. 3,223 crore (up 80% y-o-y and versus Rs. 172 crore in Q3FY23) was 32%/87% above our/consensus estimate of Rs. 2,448 crore/Rs. 1719 crore led by substantially higher-than-expected other income of Rs. 1,551 crore (up 131% q-o-q) and lower depreciation/interest cost, down 6%/23% q-o-q. For FY23, HPCL reported EBITDA/net loss of Rs. 9031 crore/Rs. 8974 crore (versus positive EBITDA/PAT of Rs. 8921 crore/Rs. 6383 crore in FY22) due to losses to in the marketing segment on account of non-revision of auto fuel prices, despite high oil price which offsets benefit of high GRMs of $12.1/bbl (versus $7.2/bbl in FY22).

Key positives

- Higher-than-expected GRM of $14/bbl (up 53% q-o-q) versus estimate of $10/bbl.
- Strong recovery in blended derived gross marketing margin at Rs. 4,406/tonne, up 65% q-o-q.
- Beat in refinery/pipeline throughput at 5 mmt/6.1 mmt, up 2.7%/5% q-o-q.

Key negatives

- Gross debt remained high at Rs. 64,517 crore as of March 2023.

Revision in estimates – We have lowered our FY24-25 earnings estimate by 5-7% to factor FY23 P&L and balance sheet numbers and slightly lower GRM assumption.

Our Call

Valuation – Maintain Buy on HPCL with a revised PT of Rs. 300: Normalisation of crude oil price (recently declined to $74/bbl) and potential recovery in GRMs would drive earnings revival for OMCs over FY24-25 to normalize PAT of Rs. 9,000-9,800 crore as seen in FY21. Moreover, HPCL's valuation of 3.8x its FY2025E EPS and 1x its FY2025E P/BV is attractive and FY24E DPS implies a 9% dividend yield. Hence, we maintain a Buy on HPCL with a revised PT of Rs. 300 (increase in PT reflects rollover of PE multiple to FY25E EPS).

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	4,38,894	3,73,252	3,51,296
OPM (%)	2.6	-2.1	4.0	4.6
Adjusted PAT	6,383	-8,974	9,086	9,768
% y-o-y growth	-40.1	-240.6	-201.2	7.5
Adjusted EPS (Rs.)	45.0	-63.3	64.1	68.9
P/E (x)	5.8	-4.1	4.1	3.8
P/B (x)	1.0	1.3	1.1	1.0
EV/EBITDA (x)	8.4	-10.6	5.3	4.8
RoNW (%)	17.0	-26.9	29.9	27.2
RoCE (%)	11.6	-11.2	16.1	16.8

Source: Company Data; Sharekhan Estimates

Strong performance led by sharp recovery in marketing margin; robust GRM at $14/bbl

Q4FY23 standalone operating profit of Rs. 4,407 crore (up 2.5x y-o-y; up 3.4x q-o-q) was 18% above consensus estimate of Rs. 3,731 crore but 9% below our estimate of Rs. 4,831 crore. A sharp beat in operating profit versus consensus estimate was driven by a strong recovery in gross marketing margin Rs. 4,406/tonne (up 65% q-o-q) and higher-than-expected GRM of $14/bbl (up 53% q-o-q and versus estimate of $10-11/bbl). Volume performance was strong with 3%/7%/11% beat in refinery throughput/marketing volume/pipeline throughput at 5 mmt/11 mmt/6 mmt, up/down/up 2.7%/1.2%/5% q-o-q. Reported standalone PAT of Rs. 3,223 crore (up 80% y-o-y and versus Rs. 172 crore in Q3FY23) was 32%/87% above our/consensus estimate of Rs. 2448 crore/Rs. 1719 crore led by substantially higher-than-expected other income of Rs. 1551 crore (up 131% q-o-q) and lower depreciation/interest cost, down 6%/23% q-o-q.

In FY23, HPCL reported EBITDA/net loss of Rs. 9031 crore/Rs. 8974 crore (versus positive EBITDA/PAT of Rs. 8921 crore/Rs. 6383 crore in FY22) due to losses to in marketing segment on account of non-revision of auto fuel price despite high oil prices, which offset high GRMs of $12.1/bbl (versus $7.2/bbl in FY22).

Results (standalone) Rs cr

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Revenue	**1,07,537**	**97,227**	**10.6**	**1,09,222**	**-1.5**
Total Expenditure	1,03,129	95,474	8.0	1,07,932	-4.4
Operating profit	**4,407**	**1,752**	**151.5**	**1,290**	**241.6**
Other Income	1,551	1,944	-20.2	670	131.4
Interest	523	328	59.2	682	-23.3
Depreciation	1044	1083	-3.6	1110	-6.0
PBT	4,392	2,285	92.2	168	2,507.4
Tax	1169	490	138.8	-4	NA
Reported PAT	**3,223**	**1,795**	**79.5**	**172**	**1,768.9**
Equity Cap (cr)	142	142	0.0	142	0.0
Reported EPS (Rs.)	22.7	12.7	79.5	1.2	1,768.9
Margins (%)			**BPS**		**BPS**
OPM	4.1	1.8	229.6	1.2	291.7
NPM	3.0	1.8	115.0	0.2	283.9
Tax rate	26.6	21.4	519.1	-2.4	NA

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)
Reported GRM ($/bbl)	14.0	12.4	12.6	9.1	53.3
Refining throughput (mmt)	5.0	4.7	5.8	4.8	2.7
Market sales including exports (mmt)	11.1	10.7	4.1	11.3	-1.2
Pipeline throughput (mmt)	6.1	5.3	15.2	5.8	5.0

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 9FY23 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, a 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 that the recent decline in the Brent crude price, a likely recovery in refining to mid-cycle level and normalization of marketing margins would drive recovery in earnings of OMCs over FY24-FY25.

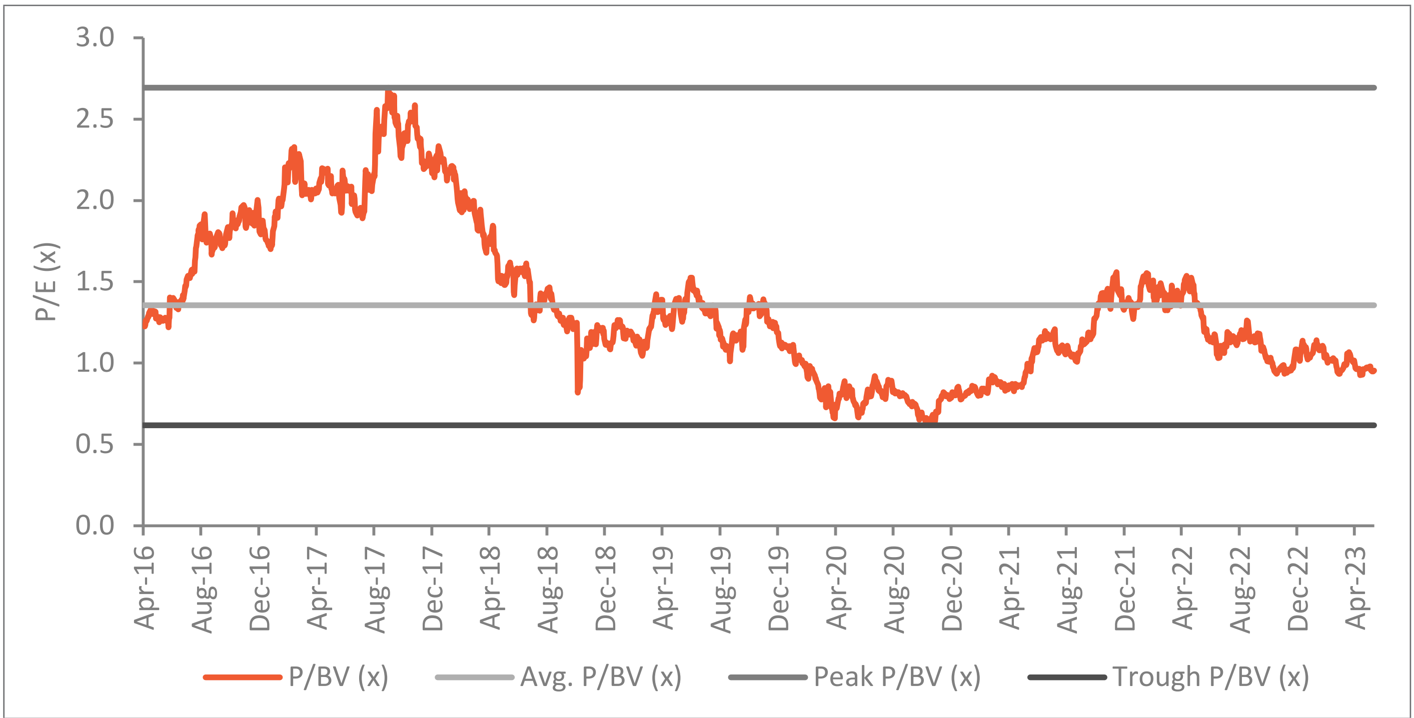
■ **Company Outlook – Expect gradual earnings recovery**

Post a steep loss in 9MFY23, HPCL's Q4FY23 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 normalise from over FY24-25 supported by recovery in refining margin and marketing margins (declining auto fuel under-recoveries and expectations of positive auto fuel marketing margin). Likely normalisation of international crude oil prices and stable-to-recovering GRMs hold the key for an earnings revival for OMCs.

■ **Valuation – Maintain Buy on HPCL with a revised PT of Rs. 300**

Normalisation of crude oil price (recently declined to $74/bbl) and potential recovery in GRMs would drive earnings revival for OMCs over FY24-25 to normalize PAT of Rs. 9,000-9,800 crore as seen in FY21. Moreover, HPCL's valuation of 3.8x its FY2025E EPS and 1x its FY2025E P/BV is attractive and FY24E DPS implies a 9% dividend yield. Hence, we maintain a Buy on HPCL with a revised PT of Rs. 300 (increase in PT reflects rollover of PE multiple to FY25E EPS).

One-year forward P/E (x) band



Source: Sharekhan Research

About the 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 21,186. HPCL also operates petroleum product pipeline network with capacity of 27mtpa and markets ~43 mmt of petroleum products. Post Vizag refinery expansion, HPCL's refining capacity would expand to 24.5mtpa and the company 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 and likely normalization of diesel marketing margin given recent fall in crude oil price. Hence, we expect earnings of OMCs to normalize gradually over FY24-25 post steep losses in FY23. HPCL's valuation is attractive, and the stock offers high dividend yield on FY24E DPS.

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: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4.9
2	HDFC Asset Management Co Ltd	4.4
3	ICICI Prudential Asset Management	2.6
4	Republic of Singapore	2.1
5	Vanguard Group Inc/The	1.8
6	BlackRock Inc	1.4
7	HDFC Life Insurance Co Ltd	1.0
8	Franklin Resources Inc	1.0
9	Kotak Mahindra Asset Management Co	0.9
10	DSP Investment Managers Pvt Ltd	0.9

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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