Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update | Result Update

Hindustan Petroleum Corporation Ltd

Stellar Q2; potential value unlocking from lubes biz. key catalyst

Oil & Gas		Sharekhan code: HINDPETRO	
Reco/View: Buy	↔	CMP: Rs. 279	Price Target: Rs. 320 ↔

↑ 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 39.86

Updated Aug 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. 39,528 cr
52-week high/low:	Rs. 310/204
NSE volume: (No of shares)	41.4 lakh
BSE code:	500104
NSE code:	HINDPETRO
Free float: (No of shares)	64.0 cr

Shareholding (%)

Promoters	54.9
FII	13.3
DII	22.6
Others	9.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	11	5	10	36
Relative to Sensex	12	7	5	30

Sharekhan Research, Bloomberg

Summary

- Q2 standalone PAT of Rs. 5,118 crore was significantly above our estimate, led by better-than-expected marketing margin, inventory gain, higher other income and lower tax rate.
- GRM improved by 79% q-o-q to $13.3/bbl but was below our estimate of $15.5/bbl as well at a discount of $5/bbl versus peers.
- After super-strong H1, the earnings environment would be challenging for OMCs in H2FY24 as Brent crude oil is on the boil and slump in GRMs. The normalisation of geopolitical risk premiums in oil prices is key to improving sentiments.
- We maintain a Buy on HPCL with an unchanged PT of Rs. 320 on inexpensive valuation of 3.7x/0.9x FY25E EPS/BV and FY25E dividend yield of ~8-9%. Potential IPO for lubes business or induction of strategic investor could unlock value.

Hindustan Petroleum Corporation Limited (HPCL) posted strong Q2FY24 results with a large beat of 56%/87% in standalone operating profit/PAT at Rs. 7836 crore/Rs. 5118 crore, down 19%/18% q-o-q led by better-than-expected marketing performance and inventory gain of Rs2,100 crore (marketing/refinery inventory gain of Rs1200 crore/Rs900 crore). Although GRM grew strongly by 79% q-o-q to $13.3/bbl but missed our estimate of $15.5/bbl and was at discount $5/bbl to peers. Refinery throughput/marketing volume of 5.8mmt/10.7mmt, up 6.5%/down 9.4% q-o-q was in-line while pipeline throughput of 6.1 mmt (down 5.5% q-o-q) was % below our estimate. The sequential decline in the earnings should be seen from the high base of Q1FY24.

Key positives

- Better-than-expected marketing margin.

Key negatives

- Lower-than-expected GRM of $13.3/bbl.

Management Commentary

- Capex plan of Rs75k crore over the next 5 years. Mix - 25-30% on RE/gas, 20% on refinery and 50-55% on marketing. The focus would be on investment in RE, gas, biofuels and value addition in the refinery.
- This fiscal HPCL to decide on IPO for lubes business or induction of a strategic partner.
- **Rajasthan refinery** – Capex plan of Rs73k crore; out of which Rs37k crore already spent; 72% project work completed. Refinery part to be completed by Mar'24 and followed by Petchem. D/E of Rs48.6k crore/Rs24.4k crore. HPCL equity contribution at Rs18k crore (Rs9.5k crore already invested). Expect GRM/EBITDA of $20/bbl and Rs8k crore.
- **Vizag refinery** – Expect to operate at 13.7mt in Q4FY24 and would further ramp up to 15mt post commissioning of bottom upgradation unit. Commissioned Hydrocracker which would improve diesel yield.
- **Product sourcing** – Post Rajasthan refinery entire 100%/70% of diesel/petrol would be sourced from HPCL/JV refineries.

Revision in estimates – We have raised our FY24-25 earnings estimate to factor in higher GRM assumption, offsetting lower auto fuel marketing margin. We have also introduced our FY26 earnings estimate in this report.

Our Call

Valuation – Maintain Buy on HPCL with an unchanged PT of Rs. 320: HPCL's valuation of 3.7x its FY2025E EPS and 0.9x its FY2025E P/BV is attractive, and stock offers high ~8-9% dividend yield based on FY25E DPS. Hence, we maintain a Buy on HPCL with an unchanged PT of Rs. 320. Sustained high crude oil prices is a key risk to earnings recovery, especially given OMCs' inability to hike petrol/diesel price given the general election expected in May 2024.

Key Risks

Lower-than-expected auto fuel marketing margin in case of a spike in crude oil price amid a continued inability to raise petrol/diesel prices and lower-than-expected refining margins remain a key risk to earnings and valuation.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E	FY26E
Revenue	3,48,428	4,38,894	3,73,252	3,51,296	3,51,296
OPM (%)	2.6	-2.1	6.1	4.8	5.1
Adjusted PAT	6,383	-8,974	15,106	10,642	11,106
% y-o-y growth	-40.1	-240.6	-268.3	-29.5	4.4
Adjusted EPS (Rs.)	45.0	-63.3	106.5	75.0	78.3
P/E (x)	6.2	-4.4	2.6	3.7	3.6
P/B (x)	1.0	1.4	1.1	0.9	0.8
EV/EBITDA (x)	8.7	-10.9	3.4	4.5	3.9
RoNW (%)	17.0	-26.9	47.0	26.8	24.1
RoCE (%)	11.6	-11.2	24.7	17.6	18.1

Source: Company; Sharekhan estimates

Strong Q2; PAT beat estimate on better-than-expected marketing performance & inventory gain

Standalone operating profit of Rs7,836 crore (down 19% q-o-q) was significantly above our estimate of Rs5014 crore. The large beat could be attributed to better-than-expected marketing margin and inventory gains. The sequential decline in operating profit was due to the exceptionally high base of Q1FY24. GRM at $13.3/bb (up 79%) was below our estimate of $15.5/bbl and at a discount of $5/bbl versus peers. Volumes were broadly line with refinery throughput/ marketing volume at 5.8mmt/10.7mmt, up 6.5%/down 9.4% q-o-q. PAT of Rs5118 crore (down 17.5% q-o-q) was 87% above our estimate, led by better marketing margin, inventory gain, higher other income and lower tax rate.

Results (standalone) Rs cr

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Revenue	**95,320**	**1,08,056**	**-11.8**	**1,11,961**	**-14.9**
Total Expenditure	87,484	1,09,915	-20.4	1,02,306	-14.5
Reported operating profit	7,836	-1,859	NA	9,655	-18.8
Adjusted operating profit	**7,836**	**-7,476**	**NA**	**9,655**	**-18.8**
Other Income	725	642	13.0	628	15.5
Interest	579	595	-2.6	588	-1.5
Depreciation	1240	1081	14.7	1364	-9.1
Reported PBT	6,742	-2,893	NA	8,331	-19.1
Adjusted PBT	**6,742**	**-8,510**	**NA**	**8,331**	**-19.1**
Tax	1624	-721	NA	2127	-23.6
Reported PAT	5,118	-2,172	NA	6,204	-17.5
Adjusted PAT	**5,118**	**-6,389**	**NA**	**6,204**	**-17.5**
Equity Cap (cr)	142	142		142	
Reported EPS (Rs)	36.1	-15.3	NA	43.7	-17.5
Adjusted EPS (Rs)	36.1	-45.0	NA	43.7	-17.5
Margins (%)			**BPS**		**BPS**
Adjusted OPM	8.2	-1.7	NA	8.6	-40.2
Adjusted NPM	5.4	-2.0	NA	5.5	-17.2
Tax rate	24.1	24.9	-83.3	25.5	-143.9

Source: Company, Sharekhan Research

Key operating metrics

Operating performance	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Reported GRM ($/bbl)	13.3	8.4	58.5	7.4	79.2
Refining throughput (mmt)	5.8	4.5	28.1	5.4	6.5
Market sales including exports (mmt)	10.7	10.4	3.4	11.9	-9.4
Pipeline throughput (mmt)	6.1	5.5	10.8	6.5	-5.5

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - The inability to hike petrol and diesel prices a concern for OMCs

OMCs' earnings remained stressed in 9MFY23 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.

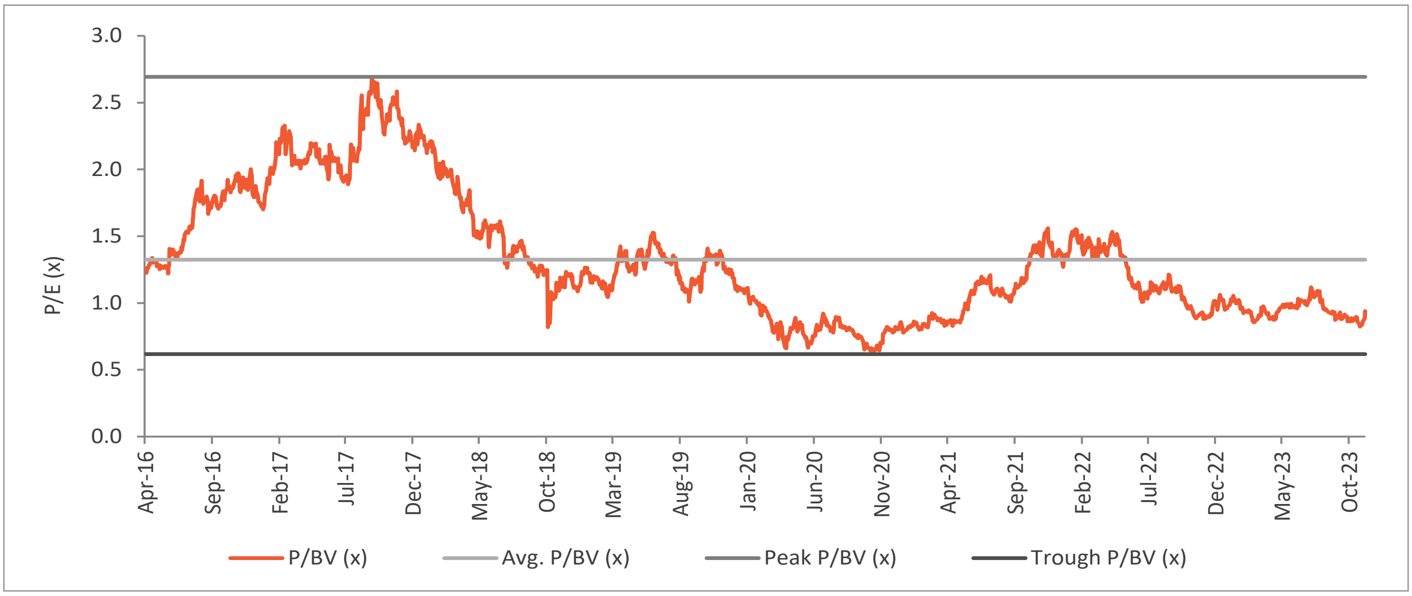
■ Company outlook - H2 earning environment challenging

Over Q4FY23 to Q2FY24, earnings performance has been strong and reflects high GRM and better auto fuel marketing margins. Post super strong H1 earnings, we believe that the earnings environment will be tough for OMC in H2FY24 given a sharp rise in Brent crude oil price and steep fall in GRM. If high crude oil sustains, then OMCs may also incur large auto fuel under-recoveries and the same result in losses in H2FY24.

■ Valuation - Maintain Buy on HPCL with an unchanged PT of Rs. 320

HPCL's valuation of 3.7x its FY2025E EPS and 0.9x its FY2025E P/BV is attractive, and stock offers high ~8-9% dividend yield based on FY25E DPS. Hence, we maintain a Buy on HPCL with an unchanged PT of Rs. 320. Sustained high crude oil prices is a key risk to earnings recovery, especially given OMCs' inability to hike petrol/diesel price given the general election expected in May 2024.

One-year forward P/BV (x) band



Source: Sharekhan Research

About company

HPCL is engaged in the business of crude oil refining and marketing of petroleum products. The company has a standalone refining capacity of 20.5 mmt (Mumbai/Vizag refinery capacity of 9.5mtpa/11mtpa) and retail fuel outlets of 21,242. HPCL also operates a petroleum product pipeline network with a capacity of 27mtpa and markets ~43 mmt of petroleum products. The company is under the process to expand its Vizag refinery to 15mtpa and is implementing refinery project with capacity of 9mtpa at Barmer in Rajasthan.

Investment theme

Earning environment to be tough for OMC in H2FY24 given the sharp rise in Brent crude oil price and steep fall in GRM. The normalisation of geopolitical risk premiums in oil prices is key to improving sentiments for OMCs. HPCL's valuation is attractive, and the stock offers a high dividend yield on FY25E DPS.

Key Risks

- Lower-than-expected auto fuel marketing margin in case of a spike in crude oil price or auto fuel price cut.
- 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

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

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.13
2	HDFC Asset Management Co Ltd	4.82
3	ICICI Prudential Asset Management	3.64
4	Republic of Singapore	1.81
5	Vanguard Group Inc/The	1.80
6	BlackRock Inc	1.34
07	Kotak Mahindra Asset Management Co	1.30
8	Jupiter Fund Management PLC	0.83
9	DSP Investment Managers Pvt Ltd	0.82
10	Franklin Resources Inc	0.70

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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by BNP PARIBAS

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