Hindustan Petroleum

Oil & Gas

Fuel price cut finally here; extent of cut DOES NOT impact business case

The Ministry of Petroleum and Natural Gas officially announced a price cut of INR 2/ltr for both petrol and diesel across the country, which will be borne entirely by the OMCs with effect from 15 Mar'24. Despite the sentiment attached to the price cuts, we in fact are enthused by the reasonable level of price cuts, given the market realities, investment needs of the OMCs and the need to absorb the recent LPG price cut over FY25E if needed. We maintain that our assumptions of gross margins of INR 3.2/ltr (net margins of ~INR 1.7/ltr) for FY25E and INR 3.5/ltr for FY26E (~net INR 1.9/ltr) face no downside risk from this pricing action; and the combination of higher refining throughput (Vizag) along with the addition of petchem (Rajasthan) creates strong momentum for HPCL over the next 2-3 years. Reiterate **BUY**.

Margins remain at normalised levels, even post cut

Our estimates indicate that at the revised retail prices, retail fuel margins (based off spot prices as of 14 Mar'24) remain at relatively steady levels of INR 4/ltr for petrol and ~INR 2/ltr for diesel, implying a blended margin of INR 2.6-2.7/ltr. This is no doubt a sharp decline from the 9MFY24 average of INR 7.2/ltr for petrol and INR 2.6/ltr for diesel (blended retail margin at INR 4/ltr) but given only 15 days odd impact for March, FY24E blended margins do not get impacted materially from this cut, in our opinion. Also, for Q1FY25E, if we assume current level of crude and product spreads, net retail margins should still average >INR 2.5/ltr – well above our base case estimate of ~INR 1.7-1.9/ltr for FY25-26E.

Sentiment aside, business case remains unblemished

HPCL with its still outsized dependence on marketing for its earnings (>55% of gross margins comes via the marketing segment) does remain vulnerable to swings in retail margins in earnings. However, we note that the dependence has been reducing vs. historical averages (FY20-22 marketing share of gross margins at >66%) and with Vizag and Rajasthan refinery throughput getting added over FY25-27E, stability of the business will improve. Additionally, in any case, we do not see this price cut hurting earnings materially over FY25-26E, unless there is a sharper swing upward in international prices and/or this cut is merely a harbinger of deeper cuts to come, which we believe is unlikely.

Financial Summary

Y/E March (INR mn)	FY23A	FY24E	FY25E	FY26E
Net Revenue	44,07,093	41,99,620	46,47,297	49,00,468
EBITDA	(72,071)	1,94,746	2,36,163	2,52,313
EBITDA %	(1.6)	4.6	5.1	5.1
Net Profit	(69,802)	1,25,823	1,48,427	1,68,231
EPS (INR)	(49.2)	88.7	104.6	118.6
EPS % Chg YoY	(195.7)	(280.3)	18.0	13.3
P/E (x)	(10.2)	5.6	4.8	4.2
EV/EBITDA (x)	(18.8)	7.5	6.0	5.3
RoCE (Pre-tax) (%)	(12.2)	11.6	11.6	10.3
RoE (%)	(19.0)	34.3	31.6	28.0

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Market Data

Market Cap (INR)	709bn
Market Cap (USD)	8,563mn
Bloomberg Code	HPCL IN
Reuters Code	HPCL.BO
52-week Range (INR)	595 /220
Free Float (%)	45.0
ADTV-3M (mn) (USD)	59.4

Price Performance (%)	3m	6m	12m
Absolute	33.1	93.5	118.7
Relative to Sensex	29.4	85.2	92.4

Previous Reports

26-01-2024: Q3FY24 results review

07-12-2023: Company Update

Valuations leave enough leeway for material upside; maintain BUY

At current price, valuations of 4.2x FY26E PER and 5.3x FY26E EV/EBITDA provide enough leeway for further outperformance over the next 12-18 months, in our view. We believe that valuations are still at attractive levels and do not fully reflect the structural changes in scale and earnings profile of the company over the next three years. Our valuation for the company, at ~5.3x FY26E EV/EBITDA for the refining and marketing business, with listed investments valued at CMP delivers a revised target price of INR 625 (earlier INR 555), a material ~25% upside from CMP. Reiterate BUY.

Key upside risks: 1) Faster-than-expected revival in benchmark GRMs. 2) Recovery in petrochemical price realisations. 3) Stronger retail fuel margins. 4) Valuation of the associated businesses (CGDs, renewables etc.) coming into Street's estimates.

Key downside risks: 1) Execution delays and longer stabilisation time of the expanded capacity. 2) Prolonged downturn in both refining and petchem cycles. 3) Sustained period of uneconomic fuel price cuts beyond what we expect as of now.

Exhibit 1: Sensitivity on earnings due to reduction in Petrol and diesel margin by INR1/ltr and GRM increase by USD1/bbl

Consolidated	Units	FY25E(base case)	FY25 Sensitivity	Change
Brent	USD/bbl	90.0	90.0	
INR/USD		83	83	
Refining Throughput	MMT	24.0	24.0	
GRM	USD/bbl	10.0	11.0	1.0
Gross refining margin	INR mn	1,46,259	1,60,885	**10%**
Marketing volumes exc lubes	MT	47.2	47.2	
Gross marketing margin	INR /t	5,689.8	4,882.1	
Gross marketing margin	INR mn	2,68,480	2,30,371	**-14%**
Petrol + Diesel Volume	mn klt	38	38	
Petrol Volume	mn klt	13	13	
Diesel Volume	mn klt	25	25	
Blended Petrol + Diesel Margin	**INR/ltr**	**3.3**	**2.3**	-1.0
Petrol margin	INR/ltr	3.3	2.3	-1.0
Diesel margin	INR/ltr	3.3	2.3	-1.0
Total Gross Margin	**INR mn**	**4,68,807**	**4,45,324**	**-5%**
Total EBITDA	**INR mn**	2,36,163	2,12,680	**-10%**
Total Adj PAT	**INR mn**	1,48,427	1,30,854	**-12%**
EPS	**INR/Sh**	104.6	92.2	**-12%**

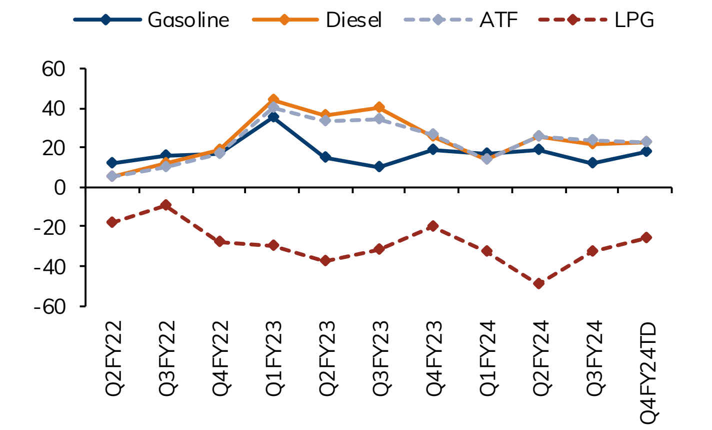
Source: Company data, I-Sec research

Exhibit 2: Q3FY24 result snapshot

INR mn	Q3FY24	Q3FY23	YoY chg %	Q2FY24	QoQ chg %	9MFY24	9MFY23	YoY chg %
Sales	**11,13,063**	**10,96,032**	**1.6**	**9,57,011**	**16.3**	**31,79,783**	**32,68,582**	**(2.7)**
EBITDA	21,636	16,716	**29.4**	82,169	**(73.7)**	1,90,455	(1,79,378)	
Adj PAT	5,290	1,724	**206.8**	51,182	**(89.7)**	1,11,105	(1,78,137)	
Reported PAT	**5,290**	**1,724**	**206.8**	**51,182**	**(89.7)**	**1,18,511**	**(1,21,967)**	
Adj EPS	3.7	1.2	**206.8**	36.1	**(89.7)**	83.5	(86.0)	
Depreciation	13,378	11,105	20.5	12,395	7.9	39,410	32,858	**19.9**
Interest	6,141	6,817	(9.9)	5,795	6.0	17,817	16,093	10.7
Employee expense	8,413	7,163	17.4	8,342	0.9	25,330	21,618	17.2
Other Income	5,564	2,889	92.6	3,445	61.5	15,285	9,091	68.1
Marketing Inventory gain (loss) (estimated)*	1,000	1,500		12,000	(91.7)	3,472	4,354	(20.2)
Forex gain (loss)	360	(4,030)		(3,640)		(1,970)	(19,510)	
Average GRM(USD/bbl)	8.5	9.1	(7.1)	13.3	(36.3)	9.8	11.4	(13.9)

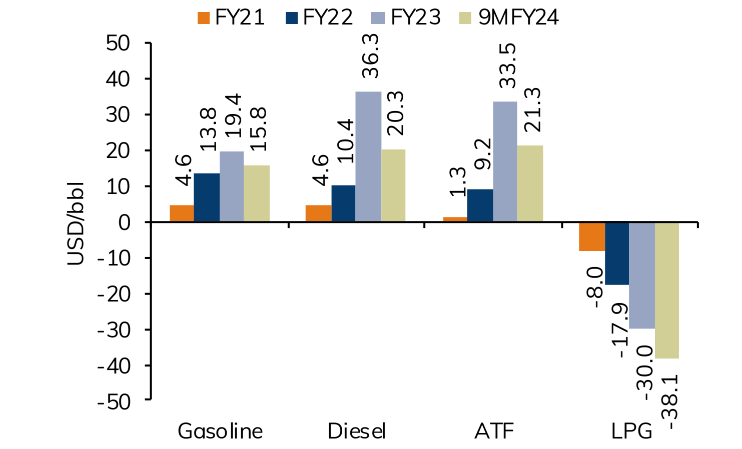
Source: Company data, I-Sec research * Estimated for Q3FY24 and Q3FY23

Exhibit 3: Improvement in Diesel, LPG and petrol spreads in Q4FY24TD



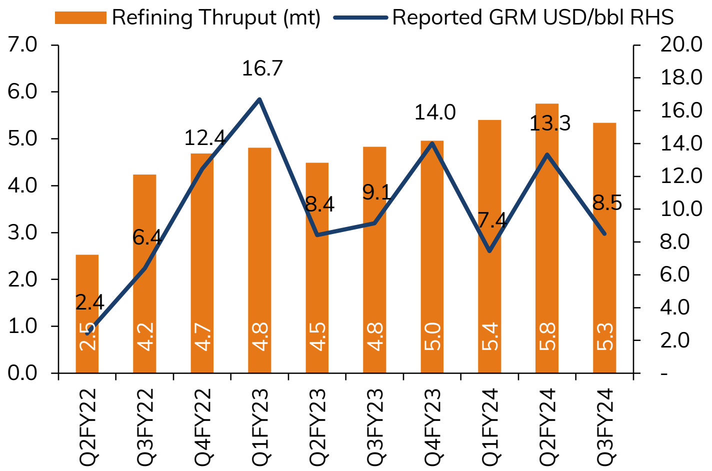
Source: Company data, I-Sec research

Exhibit 4: Product cracks remain at elevated level in 9MFY24



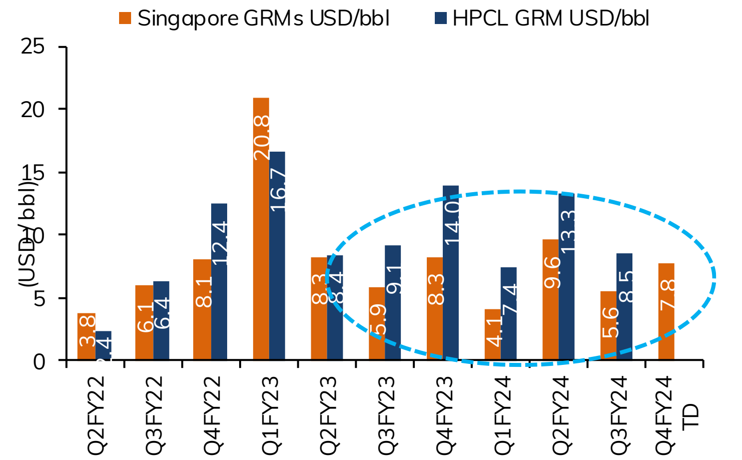
Source: Company data, I-Sec research

Exhibit 5: GRMs and throughput trend



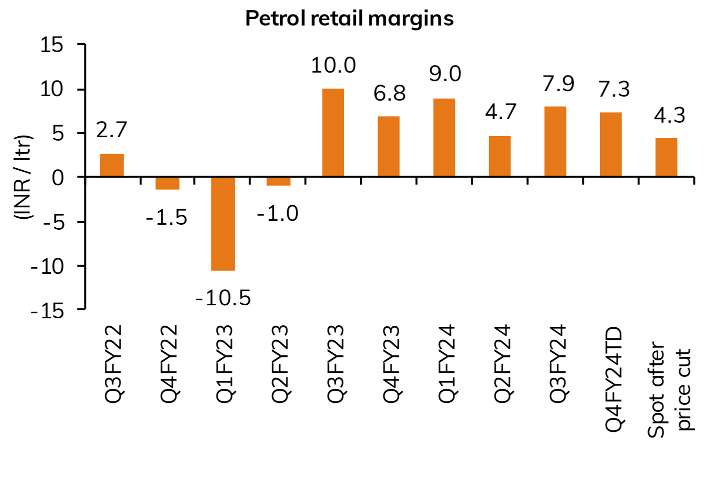
Source: Company data, I-Sec research

Exhibit 6: Premium to Singapore GRMs



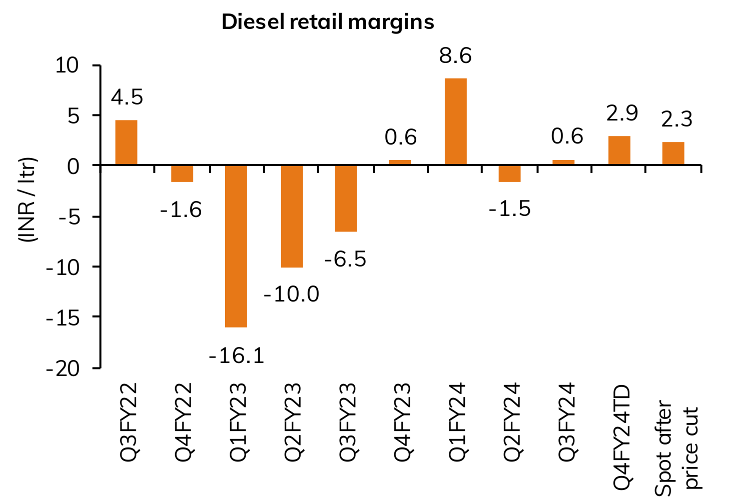
Source: Company data, I-Sec research

Exhibit 7: Petrol retail margin trend



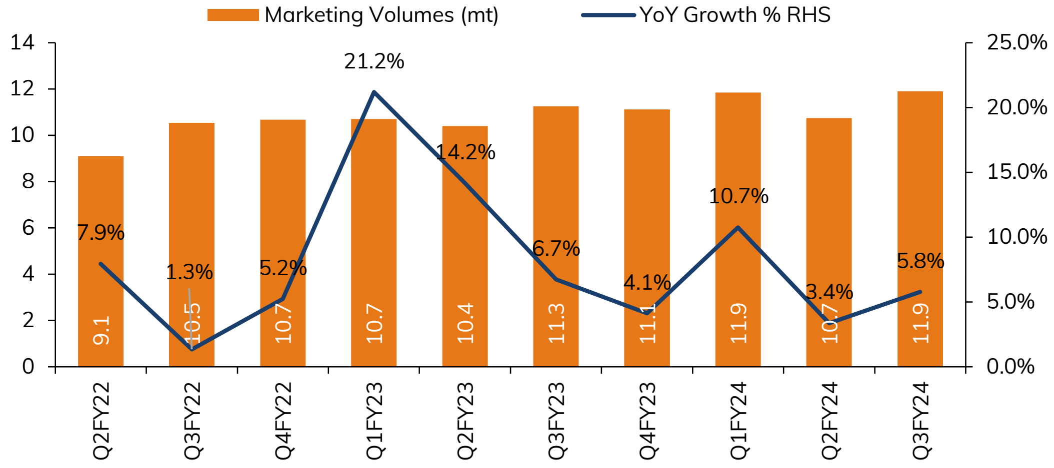
Source: Company data, I-Sec research

Exhibit 8: Diesel retail margin trend



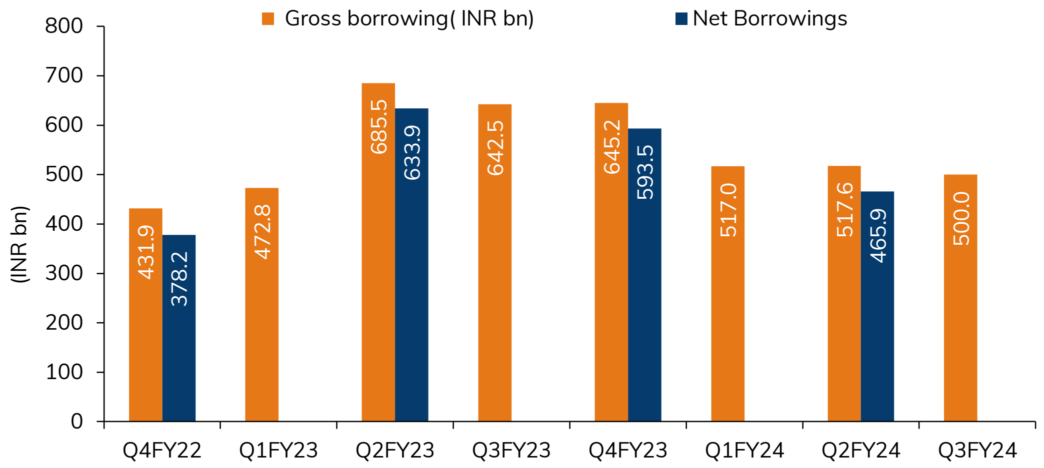
Source: Company data, I-Sec research

Exhibit 9: Strong marketing volumes trend



Source: Company data, I-Sec research

Exhibit 10: Net borrowings reduced sharply in last 4 quarters (INR bn)



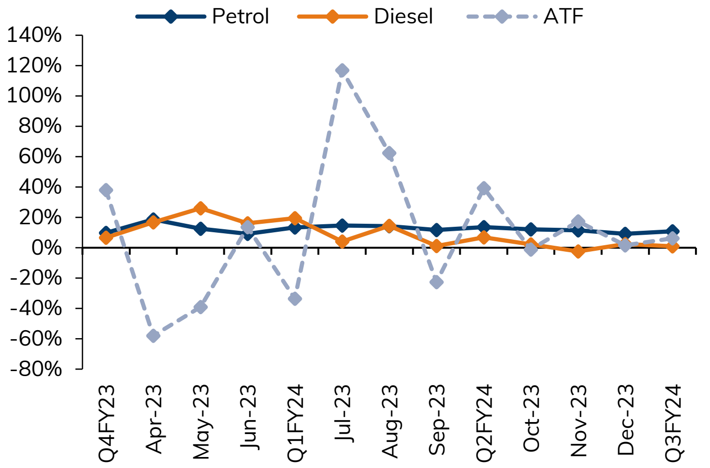
Source: Company data, I-Sec research

Exhibit 11: Gross margin trends in Q3FY24

INR mn	Q1FY23	Q2FY23	Q3FY23	Q4FY23	Q1FY24	Q2FY24	Q3FY24
Gross Margins	-68,935	-17,507	64,774	99,339	1,40,910	1,29,697	75,706
Inventory gains	22,854	-20,000	1,500	-7,758	-9,528	12,000	1,000
Net under-recovery	-	-	-	-	-	-	-
Adj Earnings	-91,789	2,493	63,274	1,07,097	1,50,438	1,17,697	74,706
Refining earnings	45,711	21,942	26,490	41,749	24,108	46,256	27,559
Pipeline margins	3,738	3,595	3,796	3,985	4,219	3,985	4,362
Marketing earnings	-1,41,237	-23,043	32,988	61,364	1,22,111	67,456	42,786
Marketing margin (INR/mt)	-13,200	-2,218	2,932	5,523	10,305	6,281	3,595
Marketing margin (USD/bbl)	-23.2	-3.8	4.9	9.2	17.2	10.4	5.9

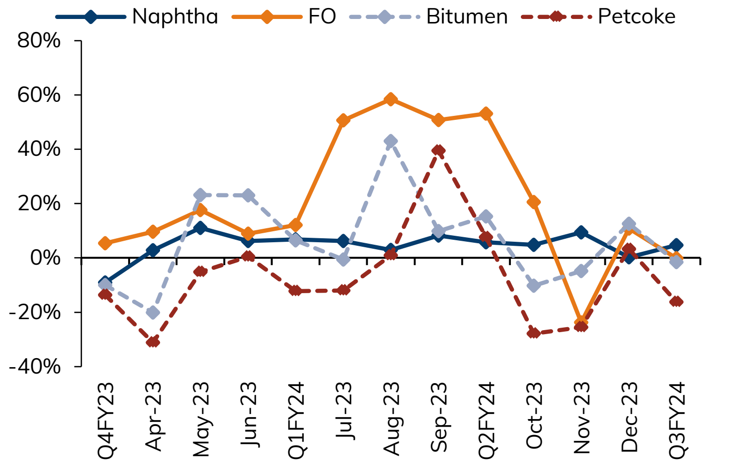
Source: Company data, I-Sec research

Exhibit 12: Transport fuel demand growth remained strong in Q3



Source: Company data, I-Sec research

Exhibit 13: Industrial fuel demand growth trends



Source: Company data, I-Sec research

Exhibit 14: Refining capacity of HPCL + JVs to rise by 16.2mt over FY23-28E

Refinery Capacity Additions (MTPA)	FY22-23	FY27-28	Capacity Addition
MR (Mumbai)	9.5	9.5	0
VR (Visakhapatnam)	8.3	15	6.7
HMEL (JV)	11.3	11.8	0.5
HRRL (Rajasthan)		9	9
Total	29.1	45.3	16.2

Source: Company data, I-Sec research

Exhibit 15: Refinery expansion status and project cost

Project	Physical Progress	Project Cost (USD bn)
MR Expansion (7.5 to 9.5 MMTPA)	Commissioned	0.6
VR Modernization (8.3 to 15.0 MMTPA)	Progressive Commissioning (96.5%)	3.2
HRRL – 9 MMTPA Green Field Refinery Petrochemical complex	72%	8.8

Source: Company data, I-Sec research

Exhibit 16: Capacity expansion to earn 9-10% pre-tax RoCE

		HRRL (Rajasthan Refinery)	Vizag*	Total
Capex	USD mn	8,800	3,200	12,000
Capacity	MMT	9.0	6.7	16
GRM	USD/bbl	20.5	11.0	32
Gross Refinery margin	USD mn	1,352	540	1,893
Less Opex	USD mn	165	123	288
EBITDA	USD mn	1,187	417	1,605
Depreciation	USD mn	352	128	480
EBIT	USD mn	835	289	1,125
ROCE Pretax		9.5%	9.0%	9.4%

* expansion of Vizag facility from 8.3 to 15MMT)

Source: Company data, I-Sec research

Exhibit 17: Petrochemical diversification boosts margin compared to traditional refinery margin potential

		HRRL (Rajasthan Refinery)	Vizag	Total
Petchem	MMT	2.4	0.15	2.55
Gross Margin	USD/t	365	365	365
Gross Margin	USD mn	876	55	931
Vs Traditional Refinery Product				
GRM	USD/bbl	10	10	10
Gross Margin	USD mn	176	11	187
Additional Gross margin due to Petchem	USD mn	700	44	744

Source: Company data, I-Sec research

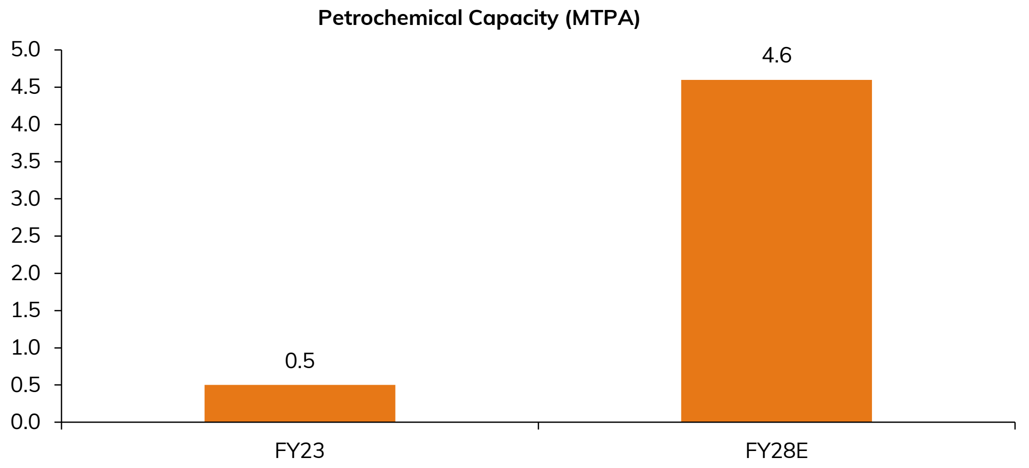
Exhibit 18: HPCL's Rajasthan refinery capacity and product yield – a one of its kind configuration for Indian downstream projects

Rajasthan Refinery	
Feed	**MTPA**
Rajasthan Crude	1.5
Imported Crude	7.5
	MTPA
Refinery process unit	9
Petchem unit	4
Products	**KTPA**
PP	1073
LLDPE	479
HDPE	479
Butadiene	146
Benzene	134
Toulene	104
MS	995
HSD	4035
Sulphur	157
Total	7602

Source: Elite petrochemical conference, HPCL, I-Sec research

Petchem capacity at HPCL's Rajasthan Refinery Ltd (JVC) would be ~2.4 MMTPA, while HMEL added 1.2 MMTPA of polymer dual feed cracker. HPCL started marketing of petrochemical under brand 'HP Durapol' and reported 15.2TMT sales in FY23-24 (up to Oct'23).

Exhibit 19: Petrochemical capacity to increase by 4.1MMT over FY23-28E



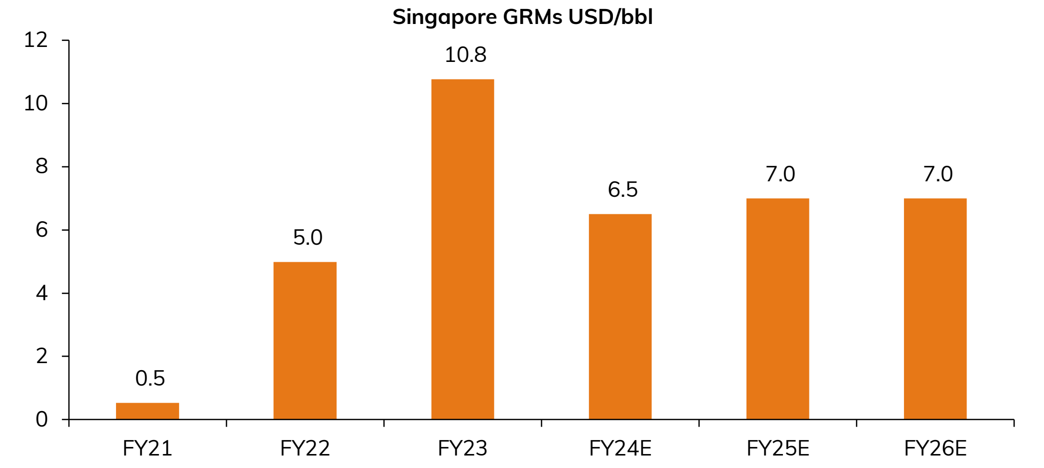
Source: Company data, I-Sec research

Exhibit 20: Investment in last five years, across segments, has been material

Area of Value Chain	Investment (INR bn)	Investment (USD bn)
Refining Capacity Expansions	310	3.8
Expansion of Pipeline Network	85	1.0
LPG Plants / POL Depots / Capacity Augmentations	58	0.7
Expansion of CGD Network	20	0.2
Enhancing Biofuels & Renewable capacities	10	0.1
Expanding Customer touch points	140	1.7
Others (R&D, Digital Transformation etc.)	100	1.2
Equity Investment in JVs & Subsidiaries	17	0.2
Total	740	8.9

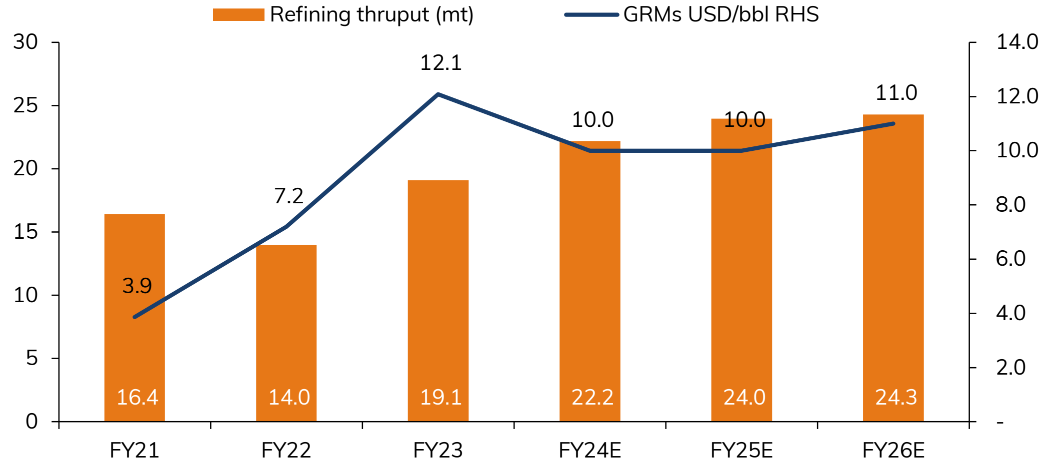
Source: Company data, I-Sec research

Exhibit 21: Singapore GRM estimates for FY20-FY26E



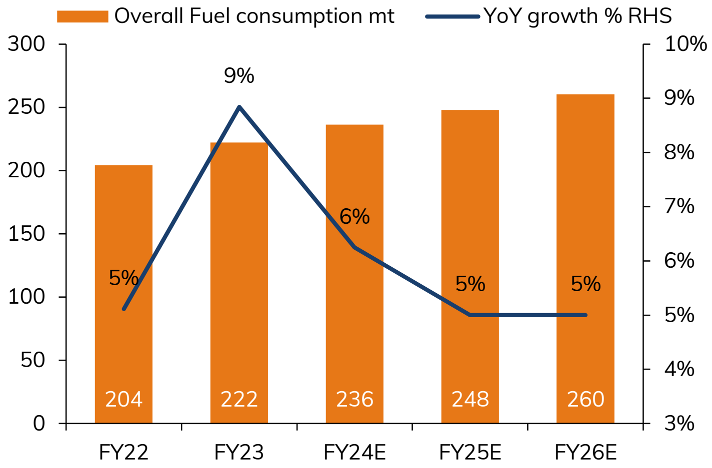
Source: Company data, I-Sec research

Exhibit 22: GRM estimates and throughputs for HPCL to improve over FY21-FY26E



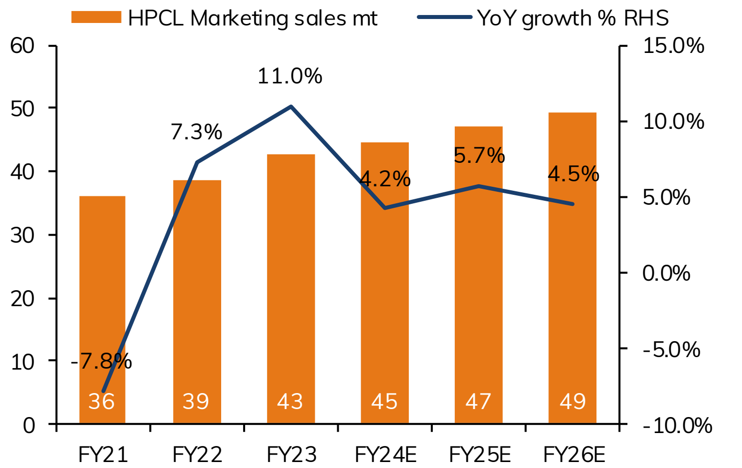
Source: Company data, I-Sec research

Exhibit 23: India fuel consumption growth trends



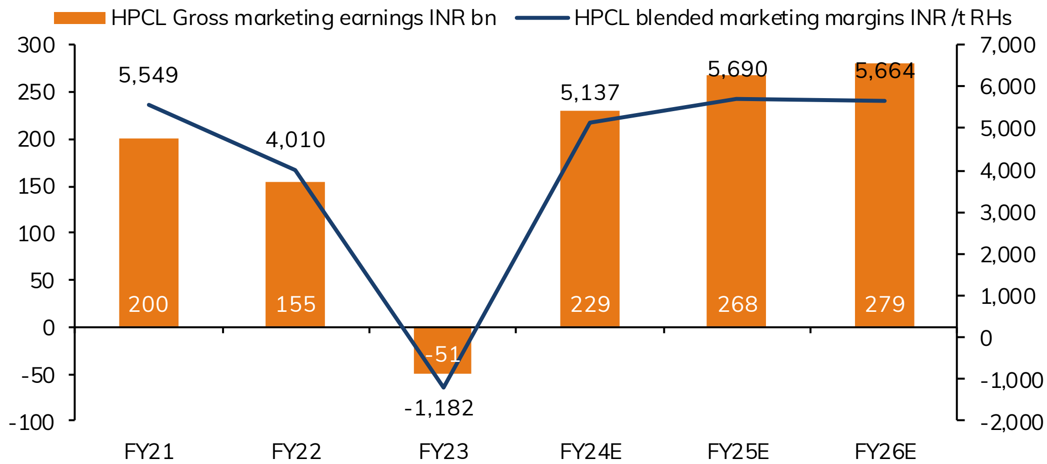
Source: Company data, I-Sec research

Exhibit 24: HPCL fuel consumption growth estimates for FY24-26E



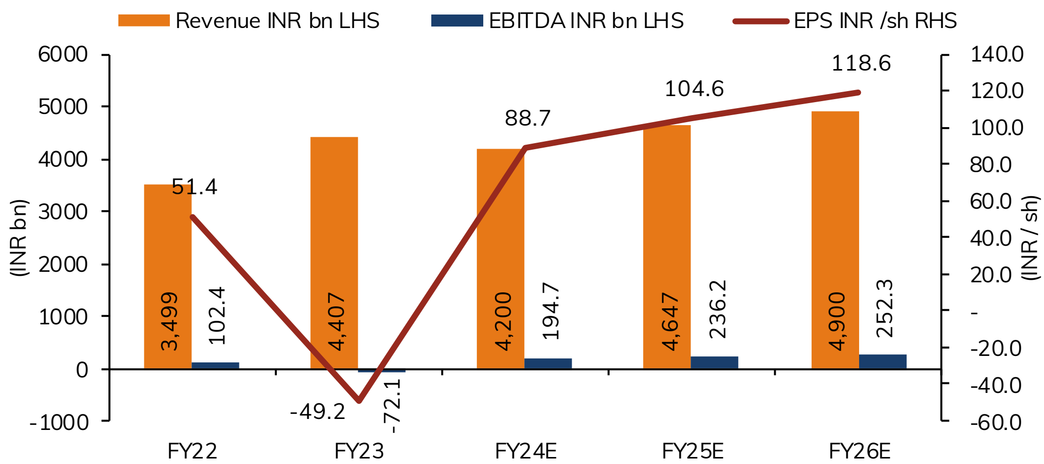
Source: Company data, I-Sec research

Exhibit 25: We expect marketing margins to recover in FY24-26E



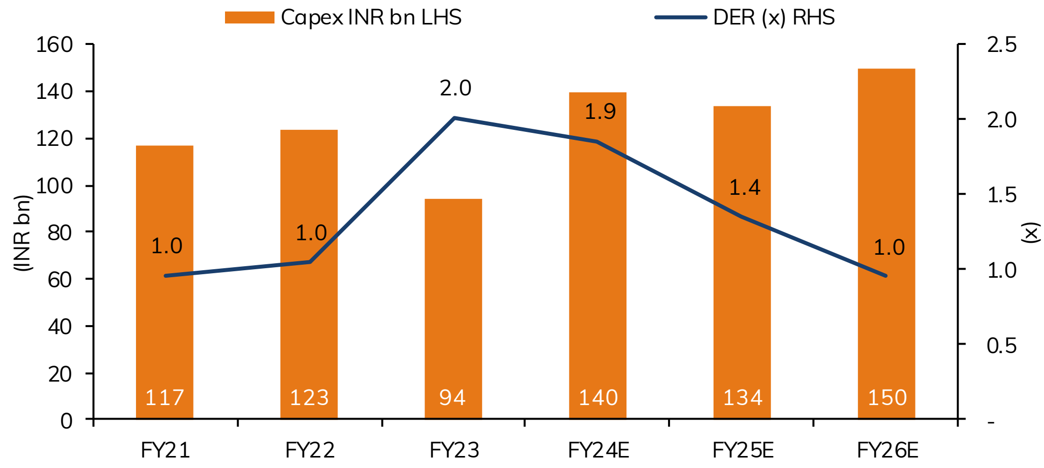
Source: Company data, I-Sec research

Exhibit 26: We expect earnings to improve over FY24-FY26E



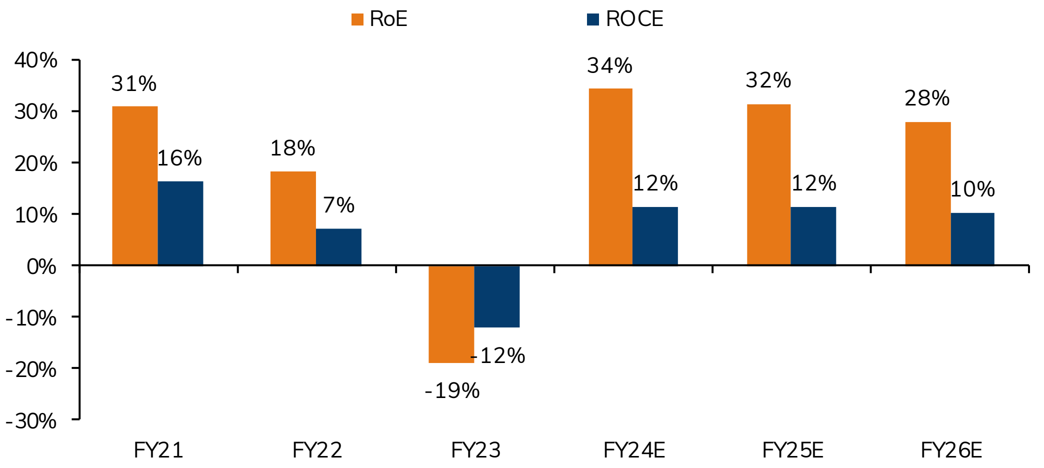
Source: Company data, I-Sec research

Exhibit 27: Capex to remain high but DER may reduce over FY24-FY26E



Source: Company data, I-Sec research

Exhibit 28: Return ratios to follow earnings trajectory and capex trends



Source: Company data, I-Sec research

Valuation remains at comfortable level

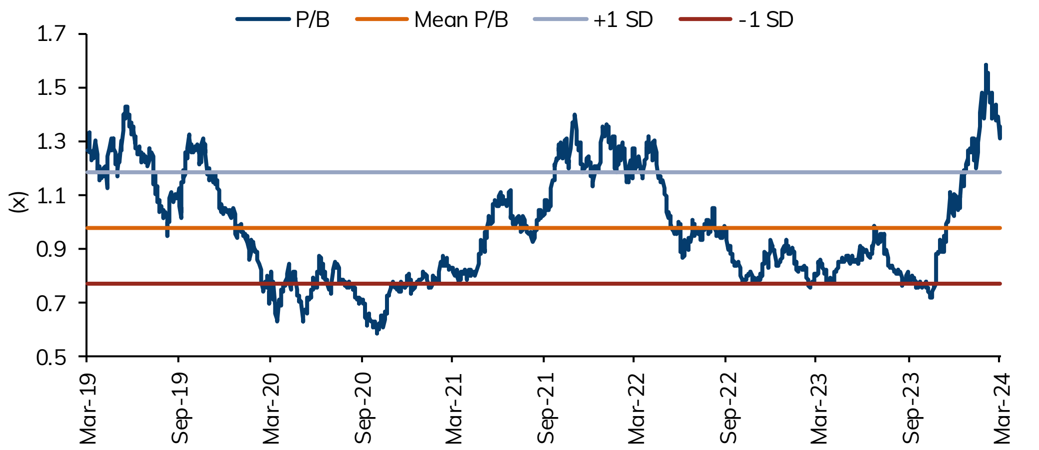
Given the improvement in GRMs, recovery in marketing margins along with Rajasthan (9mmt) and Vizag (expansion by 7mmt) refineries coming on stream over FY24-FY25, we believe current valuations of just 4.2x FY26E P/E and 5.3x FY26E EV/EBITDA are favourable. We assign 5.3x EV/EBITDA multiple to FY26E EBITDA to arrive at our enterprise value. Maintain **BUY** with a revised target price of INR 625 (earlier INR 555).

Exhibit 29: Valuation summary

INR mn	FY26E
EV	11,48,143
Mcap	7,09,274
Debt	10,68,710
Cash & Cash Eq	5,02,868
Market value of investments and oil bonds	1,26,974
EBITDA	2,52,313
EV at EBITDA of 5.3x	13,24,897
Less Net Debt	5,65,842
Add Investments	1,26,974
Equity value	8,86,029
Target Price (INR/sh)	**625**
CMP	**500**
Upside	**25%**

Source: Company data, I-Sec research

Exhibit 30: HPCL's P/B trading on higher band



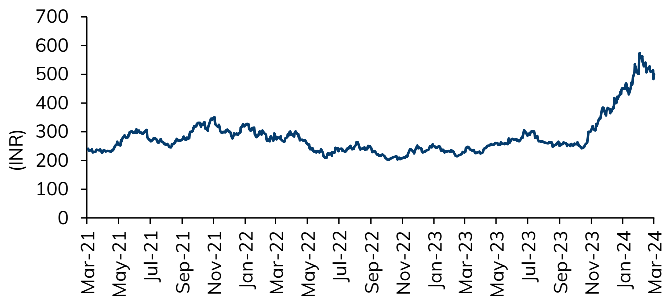
Source: Company data, I-Sec research

Exhibit 31: Shareholding pattern

%	Jun'23	Sep'23	Dec'23
Promoters	54.9	54.9	54.9
Institutional investors	36.3	35.9	35.5
MFs and other	13.5	14.3	14.1
FIs/ Banks	-	-	-
Insurance Cos.	8.4	7.9	6.6
FIIs	14.5	13.7	14.8
Others	8.8	9.2	9.6

Source: Bloomberg, I-Sec research

Exhibit 32: Price chart



Source: Bloomberg, I-Sec research

ICICI Securities

Financial Summary

Exhibit 33: Profit & Loss

(INR Mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Net Sales	**44,07,093**	**41,99,620**	**46,47,297**	**49,00,468**
EBITDA	**(72,071)**	**1,94,746**	**2,36,163**	**2,52,313**
EBITDA Margin (%)	(1.6)	4.6	5.1	5.1
Depreciation & Amortization	45,602	55,152	63,266	74,652
EBIT	(1,17,672)	1,39,593	1,72,897	1,77,661
Interest expenditure	21,741	25,191	30,621	33,501
Other Non-operating Income	14,659	19,264	29,395	36,318
PBT	**(1,24,754)**	**1,33,666**	**1,71,670**	**1,80,477**
Profit / (Loss) from Associates	**24,915**	**25,800**	**19,966**	**33,180**
Less: Taxes	(30,037)	33,644	43,209	45,426
PAT	(94,717)	1,00,022	1,28,461	1,35,051
Less: Minority Interest	-	-	-	-
Net Income (Reported)	**(69,802)**	**1,25,823**	**1,48,427**	**1,68,231**
Extraordinaries (Net)	-	-	-	-
Recurring Net Income	**(69,802)**	**1,25,823**	**1,48,427**	**1,68,231**

Source Company data, I-Sec research

Exhibit 34: Balance sheet

(INR Mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Total Current Assets	3,88,071	5,75,543	7,52,175	9,44,027
of which cash & bank	6,724	1,60,417	3,01,179	4,74,251
Total Current Liabilities & Provisions	5,46,463	6,15,261	6,46,497	6,77,837
Net Current Assets	**(1,58,392)**	**(39,718)**	**1,05,678**	**2,66,191**
Other Non Current Assets	-	-	-	-
Net Fixed Assets	6,83,875	7,93,722	9,45,456	10,45,804
Other Fixed Assets	-	-	-	-
Capital Work in Progress	2,56,074	2,31,074	1,50,000	1,25,000
Non Investment	2,33,687	3,83,687	3,83,687	3,83,687
Current Investment	51,689	51,689	51,689	51,689
Deferred Tax Assets	-	-	-	-
Total Assets	**10,66,932**	**14,20,454**	**16,36,510**	**18,72,370**
Liabilities				
Borrowings	**7,06,710**	**9,72,710**	**10,68,710**	**11,64,710**
Deferred Tax Liability	**-**	**-**	**-**	**-**
Lease Liability	-	-	-	-
Other Liabilities	37,589	37,589	37,589	37,589
Equity Share Capital	14,189	14,189	14,189	14,189
Reserves & Surplus*	3,08,443	3,95,965	5,16,021	6,55,881
Total Net Worth	**3,22,633**	**4,10,154**	**5,30,210**	**6,70,071**
Minority Interest	-	-	-	-
Total Liabilities	**10,66,932**	**14,20,454**	**16,36,510**	**18,72,370**

Source Company data, I-Sec research

Exhibit 35: Quarterly trend

(INR mn, year ending March)

	Mar-23	Jun-23	Sep-23	Dec-23
Net Sales	10,79,278	11,09,709	9,57,011	11,13,063
% growth (YOY)	11%	-3%	-7%	2%
EBITDA	47,986	86,651	82,169	21,636
Margin %	4%	8%	9%	2%
Other Income	11,600	6,277	3,445	5,564
Extraordinaries	0	-9,897	0	0
Adjusted Net Profit	32,226	54,633	51,182	5,290

Source Company data, I-Sec research

Exhibit 36: Cashflow statement

(INR Mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Cash Flow from operation before working Capital	**(46,251)**	**1,94,746**	**2,36,163**	**2,52,313**
Working Capital Changes	13,186	35,019	(4,634)	12,559
Tax	(1,598)	(33,644)	(43,209)	(45,426)
Operating Cashflow	**(34,663)**	**1,96,121**	**1,88,320**	**2,19,447**
Capital Commitments	(93,441)	(1,40,000)	(1,33,926)	(1,50,000)
Free Cashflow	**(1,28,104)**	**56,121**	**54,394**	**69,447**
Others CFI	(28,003)	(1,04,936)	49,361	69,498
Cashflow from Investing Activities	**(1,21,444)**	**(2,44,936)**	**(84,566)**	**(80,502)**
Inc (Dec) in Borrowings	2,12,508	2,66,000	96,000	96,000
Interest Cost	(32,399)	(25,191)	(30,621)	(33,501)
Others	(19,857)	(38,301)	(28,371)	(28,371)
Cash flow from Financing Activities	**1,60,252**	**2,02,508**	**37,008**	**34,128**
Chg. in Cash & Bank balance	**4,144**	**1,53,693**	**1,40,762**	**1,73,072**
Closing cash & balance	6,724	1,60,417	3,01,179	4,74,251

Source Company data, I-Sec research

Exhibit 37: Key ratios

(Year ending March)

	FY23A	FY24E	FY25E	FY26E
Per Share Data (INR)				
Recurring EPS	(49.2)	88.7	104.6	118.6
Diluted EPS	(49.2)	88.7	104.6	118.6
Recurring Cash EPS	(17.1)	127.6	149.2	171.2
Dividend per share (DPS)	-	27.0	20.0	20.0
Book Value per share (BV)	227.4	289.1	373.8	472.4
Dividend Payout (%)	-	30.4	19.1	16.9
Growth (%)				
Net Sales	25.9	(4.7)	10.7	5.4
EBITDA	(170.4)	(370.2)	21.3	6.8
EPS	(195.7)	(280.3)	18.0	13.3
Valuation Ratios (x)				
P/E	(10.2)	5.6	4.8	4.2
P/CEPS	(29.3)	3.9	3.4	2.9
P/BV	2.2	1.7	1.3	1.1
EV / EBITDA	(18.8)	7.5	6.0	5.3
EV / Operating Income	(13.2)	9.3	7.0	6.3
Dividend Yield (%)	-	0.1	0.0	0.0
Operating Ratios				
EBITDA Margins (%)	(1.6)	4.6	5.1	5.1
Effective Tax Rate (%)	24.1	25.2	25.2	25.2
Net Profit Margins (%)	(1.6)	3.0	3.2	3.4
NWC / Total Assets (%)	(14.8)	(2.8)	6.5	14.2
Fixed Asset Turnover (x)	5.1	4.1	3.8	3.5
Working Capital Days	12.5	13.6	14.7	14.4
Net Debt / Equity %	200.9	185.4	135.0	95.3
Profitability Ratios				
RoCE (%)	(9.2)	8.7	8.7	7.7
RoCE (Pre-tax) (%)	(12.2)	11.6	11.6	10.3
RoE (%)	(19.0)	34.3	31.6	28.0

Source Company data, I-Sec research

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