

HPCL

7 August 2017

Reuters: HPCL.BO; Bloomberg: HPCL IN

Inventory Loss Leads To Drop In Profitability

Hindustan Petroleum Corporation or HPCL's 1QFY18 profits declined 56% YoY and 49.2% QoQ to Rs9.2bn because of: 1) Inventory loss, gross refinery margin or GRM for 1QFY18 at US\$5.86/bbl compared to US\$8.35/bbl in 4QFY17 and US\$6.8/bbl in 1QFY17. 2) Rise in other expenses by 12.9% to Rs27.5bn in 1QFY18. The fall in net profit was mitigated by: 1) Decline in interest costs by 37% on QoQ basis to Rs1.4bn. 2) Staff costs falling 37.4% on QoQ basis to Rs7bn. 3) Other income increased to Rs 5.7bn, a 41% rise on QoQ basis. We expect crude oil prices to remain range-bound and inventory gains to be limited (if any) going forward. We expect the rising capex to have a negative impact on profitability and cash flow. We have retained Sell rating on HPCL with a target price of Rs321 (from Rs482 earlier due to the issue of bonus shares).

Earnings decline on account of inventory loss and a rise in other expenses: Net profit of HPCL stood at Rs9.2bn, down 56% YoY and 49.2% QoQ. EBITDA declined 55% YoY and 43.6% QoQ to Rs16.2bn. Other expenses grew 12.9% to Rs27.5bn in 1QFY18. Interest costs declined on QoQ basis by 37% to Rs 1.4bn. Staff costs fell 37.4% on QoQ basis to Rs7bn. Other income increased to Rs 5.7bn, a 41% rise on QoQ basis.

GRM declines significantly because of inventory loss: GRM in 1QFY18 stood at US\$5.86/bbl as compared to US\$8.35/bbl in 4QFY17 and US\$6.8/bbl in 1QFY17. HPCL faced an inventory loss of Rs16bn in 1QFY18 versus an inventory gain of Rs19.3bn in 1QFY17.

Rising capex to exert pressure on profitability: HPCL plans to incur capex of Rs71bn in 2017-18, a 21% increase compared to capex of Rs58.6bn incurred in 2016-17.

Refinery and pipeline throughput declines on QoQ basis: HPCL reported refinery throughput at 4.49mmt in 1QFY18 as compared to 4.64mmt in 4QFY17 and 4.48mmt in 1QFY17. Pipeline throughput stood at 4.65mmt in 1QFY18 versus 4.67mmt in 4QFY17. However, pipeline throughput remained the same on YoY basis.

Retain Sell rating with a target price of Rs321: Given our concerns on the likely decline in GRM, increase in capex over the next five years and the rise in interest costs, we expect the upside in earnings to be capped. We believe that with low earnings growth and a decline in RoE and RoCE, the stock will get de-rated. We have retained Sell rating on HPCL with a target price of Rs321 (from Rs482 earlier due to the issue of bonus shares).

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SELL

Sector: Oil & Gas

CMP: Rs432

Target Price: Rs321

Downside: 26%

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Key Data

Current Shares O/S (mn)	1,523.8
Mkt Cap (Rsbn/US\$bn)	659.2/10.4
52 Wk H / L (Rs)	441/254
Daily Vol. (3M NSE Avg.)	4,607,560

Price Performance (%)

	1 M	6 M	1 Yr
HPCL	26.8	19.3	61.4
Nifty Index	4.4	15.2	17.7

Source: Bloomberg

Y/E March (Rsmn)	1QFY18	4QFY17	QoQ (%)	1QFY17	YoY (%)	1QFY18E	Var (%)
Net sales	534,685	515,248	3.8	448,407	19.2	513,338	4.2
Cost of goods	(483,893)	(450,847)	7.3	(380,827)	27.1	(456,941)	5.9
Employee benefits exp.	(6,984)	(11,161)	(37.4)	(6,145)	13.7	(6,409)	9.0
Other expenses	(27,528)	(24,380)	12.9	(25,167)	9.4	(28,227)	(2.5)
EBITDA	16,280	28,860	(43.6)	36,268	(55.1)	21,761	(25.2)
EBITDAM (%)	3.0	5.6	-	8.1	-	4.2	-
Depreciation and amort.	(6,671)	(6,749)	(1.2)	(6,108)	9.2	(7,057)	(5.5)
EBIT	9,609	22,111	(56.5)	30,160	(68.1)	14,704	(34.6)
EBITM (%)	1.8	4.3	-	6.7	-	2.9	-
Other income	5,703	4,047	40.9	2,753	107.2	4,047	40.9
Interest expenses	(1,430)	(2,268)	(37.0)	(1,395)	2.5	(2,268)	(37.0)
Extraordinary/exceptional item	-	-	-	-	-	-	-
Profit before tax	13,883	23,890	(41.9)	31,518	(56.0)	16,483	(15.8)
Tax expense	(4,635)	(5,702)	(18.7)	(10,534)	(56.0)	(5,341)	(13.2)
Effective tax rate (%)	33	24	-	33	-	32	-
Reported net profit	9,248	18,188	(49.2)	20,984	(55.9)	11,142	(17.0)
NPM (%)	1.7	3.5	-	4.7	-	2.2	-

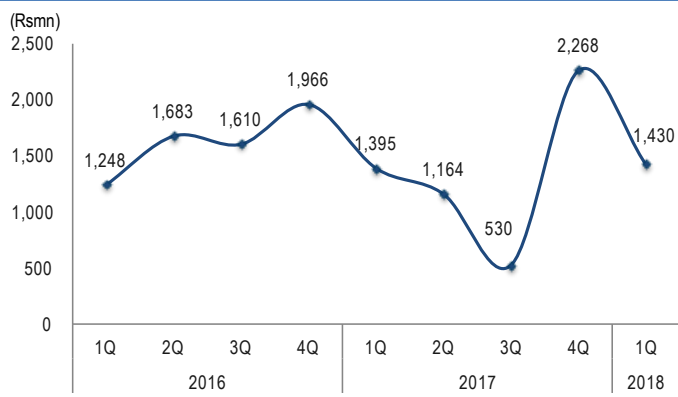
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Key financials

Y/E March (Rsmn)	FY15	FY16	FY17E	FY18E	FY19E
Revenues	1,993,508	1,755,890	1,994,975	2,202,148	2,346,022
YoY (%)	(3.6)	(11.9)	13.6	10.4	6.5
EBITDA	52,064	79,657	106,463	110,765	120,989
EBITDA (%)	(15.9)	53.0	33.7	4.0	9.2
PAT	27,333	38,627	62,280	64,310	68,577
YoY (%)	57.6	41.3	61.2	3.3	6.6
EPS (Rs)	17.9	25.3	40.9	42.2	45.0
RoE (%)	17.1	21.0	28.0	24.5	22.4
EV/EBITDA (x)	15.4	10.1	7.3	7.2	7.1
P/E (x)	24.1	17.0	10.6	10.2	9.6

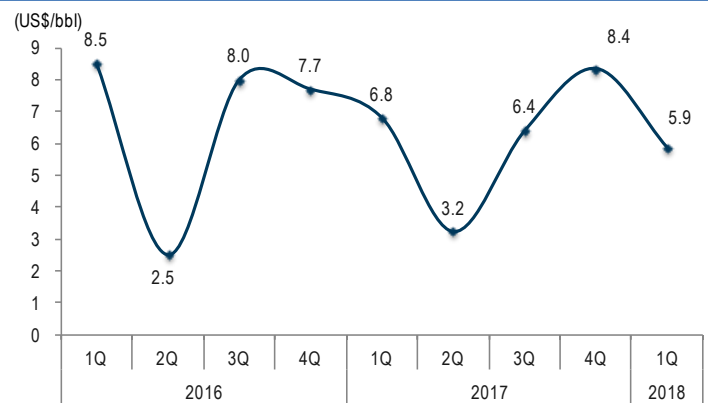
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Interest



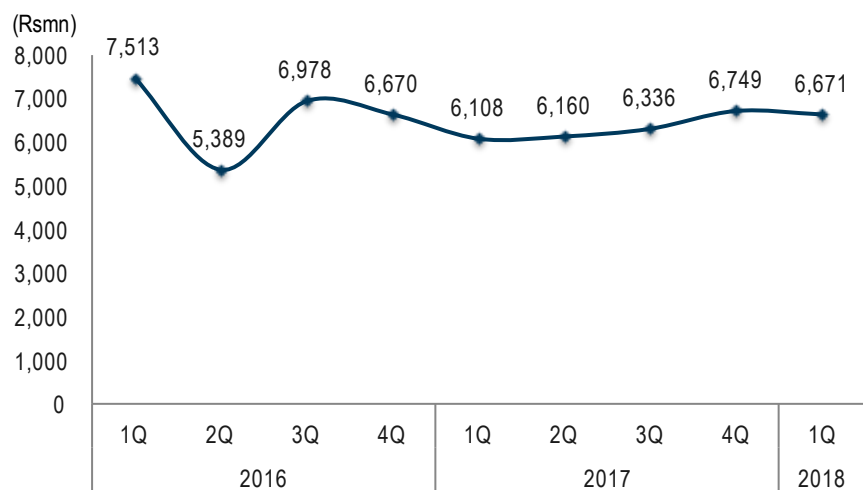
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: GRM



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Depreciation



Source: Company, Nirmal Bang Institutional Equities Research

Standalone financials

Exhibit 5: Income statement

Y/E March (Rsmn)	FY15	FY16	FY17E	FY18E	FY19E
Net sales	1,993,508	1,755,890	1,994,975	2,202,148	2,346,022
Growth YoY (%)	(3.6)	(11.9)	13.6	10.4	6.5
Operating costs	1,897,663	1,617,724	1,827,077	2,026,877	2,157,301
Staff expenses	24,147	23,145	24,303	25,518	26,794
Other expenses	19,635	35,364	37,132	38,988	40,938
EBITDA	52,064	79,657	106,463	110,765	120,989
EBITDA (%)	2.6	4.5	5.3	5.0	5.2
% growth	(15.9)	53.0	33.7	4.0	9.2
Depreciation	20,059	26,803	25,246	26,330	29,411
EBIT	32,005	52,854	81,217	84,435	91,579
EBIT (%)	1.6	3.0	4.1	3.8	3.9
Net interest expenses	5,058	5,818	2,980	2,175	3,503
Other income	14,142	14,282	14,857	13,868	14,431
Other adjustments	(452)	3,937	-	-	-
Earnings before tax	41,541	57,381	93,093	96,128	102,507
Tax-total	14,209	18,753	30,814	31,818	33,930
Rate of tax (%)	34.2	32.7	33.1	33.1	33.1
Net profit	27,333	38,627	62,280	64,310	68,577
% growth	57.6	41.3	61.2	3.3	6.6
EPS (FD)	17.9	25.3	40.8	42.2	45
% growth	57.6	41.3	61.2	3.3	6.6
DPS	5.4	7.6	13.4	13.9	14.8
Payout ratio (%)	36.5	36.4	37.9	36.7	37.9
Dividend on equity shares	8,296	11,683	20,318	20,318	22,350
Tax on dividend	1,689	2,378	3,296	3,296	3,626

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY15	FY16	FY17E	FY18E	FY19E
Share capital	3,390	3,390	10,159	15,239	15,239
Reserves and surplus	156,831	180,171	212,068	247,684	290,286
Net worth	160,221	183,561	222,227	262,923	305,525
Loans	203,353	213,368	212,118	245,118	321,118
Deferred tax liability	41,036	48,105	49,105	50,105	51,105
Capital employed	404,610	445,033	483,449	558,145	677,747
Net fixed assets	325,372	353,227	387,101	427,271	528,360
Investments	59,445	60,090	60,590	61,090	61,590
Current assets, loans	290,689	291,392	317,389	347,664	376,201
Inventories	129,723	127,091	128,928	141,621	151,994
Debtors	36,031	41,927	47,635	52,582	56,018
Cash and bank	61,281	70,245	88,196	100,331	114,559
Others	63,655	52,130	52,630	53,130	53,630
Less: Current liabilities	270,896	259,676	281,631	277,879	288,404
Current liabilities	241,106	238,108	243,608	239,757	247,709
Provisions	29,790	21,568	38,022	38,122	40,695
Net current assets	(41,488)	(38,528)	(52,437)	(30,547)	(26,762)
Total capital employed	404,610	445,033	483,449	558,145	677,747

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY15	FY16	FY17E	FY18E	FY19E
Profit after tax	27,333	38,627	62,280	64,310	68,577
Depreciation	19,788	26,594	24,746	25,830	28,911
Other income	(14,142)	(14,282)	(14,857)	(13,868)	(14,431)
Interest	5,058	5,818	2,980	2,175	3,503
Working cap changes	60,069	(6,184)	4,357	(21,891)	(6,146)
Others	2,674	3,304	999	1,000	1,000
Operating cash flow	100,778	53,878	80,505	57,556	81,413
Capex	(45,970)	(52,762)	(58,620)	(66,000)	(130,000)
Investments	(675)	(645)	(500)	(500)	(500)
Other income	14,142	14,282	14,857	13,868	14,431
Cash flow from investments	(32,503)	(39,125)	(44,263)	(52,632)	(116,069)
Equity	-	-	-	-	-
Debt	(118,233)	10,014	(1,250)	33,000	76,000
Interest expenses	(5,058)	(5,818)	(2,980)	(2,175)	(3,503)
Dividends	(6,141)	(9,985)	(14,061)	(23,614)	(23,614)
Cash flow from financing	(129,431)	(5,790)	(18,291)	7,211	48,883
Total cash generation	(61,156)	8,964	17,951	12,135	14,228
Opening cash balance	122,437	61,281	70,245	88,196	100,331
Closing cash balance	61,281	70,245	88,196	100,331	114,559

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

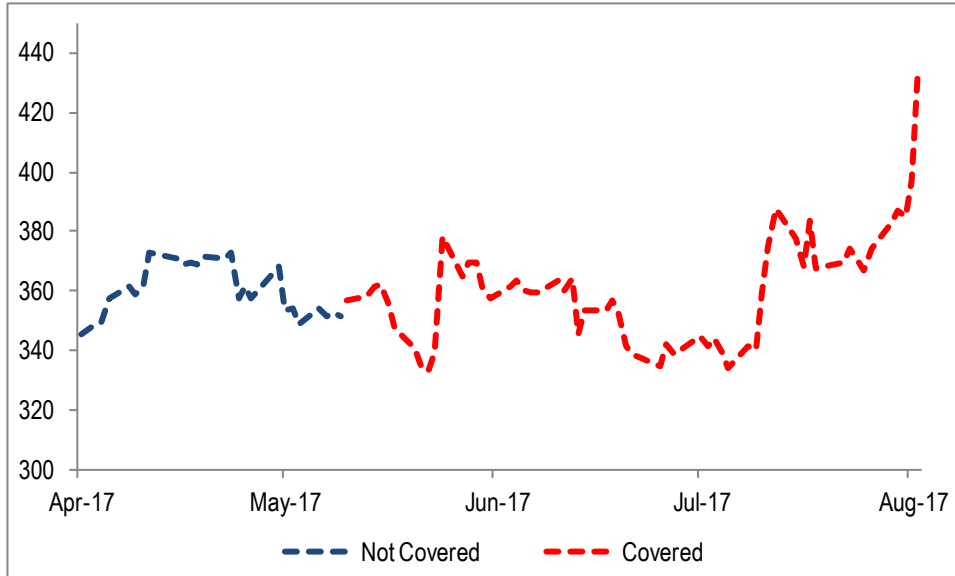
Y/E March (Rsmn)	FY15	FY16	FY17E	FY18E	FY19E
Profitability and return ratios (%)					
EBITDA margin (%)	2.6	4.5	5.3	5.0	5.2
EBIT margin (%)	1.6	3.0	4.1	3.8	3.9
Net profit margin (%)	1.4	2.2	3.1	2.9	2.9
RoE(%)	17.1	21.0	28.0	24.5	22.4
RoCE (%)	10.6	16.2	23.5	20.7	17.9
Working capital and liquidity ratios					
Receivables (days)	7	9	9	9	9
Inventory (days)	24	26	24	23	24
Payables (days)	17	15	17	17	17
Current ratio (x)	0.8	0.9	0.8	0.9	1.0
Quick ratio(x)	0.5	0.5	0.5	0.6	0.6
Valuation ratios					
EV/sales (x)	0.4	0.5	0.4	0.4	0.4
EV/EBITDA (x)	15.4	10.1	7.3	7.2	7.1
P/E (x)	24.1	17.0	10.6	10.2	9.6
P/BV (x)	4.1	3.6	3.0	2.5	2.2

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price	Target price (Rs)
12 May 2017	Sell	567	482
29 May 2017	Sell	567	482
7 August 2017	Sell	432	321

Rating Track Graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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