

HPCL

10 November 2017

Reuters: HPCL.BO; Bloomberg: HPCL IN

Good Earnings Growth On The Back Of Inventory Gains

Hindustan Petroleum Corporation or HPCL's 2QFY18 profits increased 147% YoY and 88% QoQ to Rs17bn because of: 1) Higher gross refining margin or GRM of 7.65 (US\$/bbl) versus 5.86 (US\$/bbl) in 1QFY18 and 3.55 (US\$/bbl) in 2QFY17. 2) Lower other expenses of Rs24.7bn as compared to Rs27.5bn in 1QFY18. The growth in earnings was countered by: 1) Decline in domestic sales from 9.20mmt in 1QFY18 to 8.37mmt in 2QFY18. 2) Finance costs at Rs1.5bn rising 9.3% QoQ and 34.3% YoY. 3) Other income at Rs5.1bn being lower by 8.9% QoQ and 5% YoY. We have retained Sell rating on HPCL with a target price of Rs321.

Positive earnings despite subdued sales performance: HPCL posted a net profit of Rs17bn, an increase of 147% YoY and 88% QoQ. Inventory gains led by Hurricane Harvey in the US and a decline in other expenses by 10% QoQ to Rs24.7bn contributed to positive earnings. On the EBITDA front, the company reported a margin of 6.1% in 2QFY18 versus 3% in 1QFY18. Net profit margin at 3.7% was impacted by an increase in finance costs by 34.3% YoY to Rs1.5bn and decline in other income by 8.9% QoQ to Rs5.4bn. Sales were subdued on account of poor domestic sales of 8.37mmt in 2QFY18 versus 9.20mmt in 1QFY18.

GRM rises significantly because of inventory gains: GRM in 2QFY18 stood at 7.65 (US\$/bbl) compared to 5.86(US\$/bbl) in 1QFY18 and 3.55 (US\$/bbl) in 2QFY17. The rise in GRM was on account of Hurricane Harvey which caused refinery shutdowns and refineries operating at reduced capacities in the US. Singapore GRM rallied from 6.65 (US\$/bbl) in the first week of July 2017 to 11.01 (US\$/bbl) in the first week of September 2017.

Finance costs increase sequentially: Finance costs at Rs1.5bn increased 34.3% YoY and 9.3% QoQ. Finance costs in 1HFY18 were Rs3.0bn versus Rs2.5bn in 1HFY17.

Foreign currency gains boost other income: HPCL posted Rs1.3bn as foreign currency translation gains (reported under other income) in 1HFY18 versus Rs0.5bn of foreign currency translation loss (reported in other expenses) in 1HFY17.

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.

SELL

Sector: Oil & Gas

CMP: Rs431

Target Price: Rs321

Downside: 26%

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Key Data

Current Shares O/S (mn)	1,523.8
Mkt Cap (Rsbn/US\$bn)	657.6/10.1
52 Wk H / L (Rs)	493/269
Daily Vol. (3M NSE Avg.)	5,094,002

Price Performance (%)

	1 M	6 M	1 Yr
HPCL	(1.1)	22.3	39.9
Nifty Index	2.9	9.6	20.9

Source: Bloomberg

Y/E March (Rsmn)	2QFY17	1QFY18	2QFY18	QoQ (%)	YoY (%)	2QFY18E	Var. (%)
Net sales	421,025	534,685	475,226	(11.1)	12.9	529,176	(10.2)
Cost of goods purchased	(378,405)	(483,893)	(414,330)	(14.4)	9.5	(472,595)	(12.3)
Employee benefits exp.	(6,051)	(6,984)	(7,081)	1.4	17.0	(7,123)	(0.6)
Other expenses	(23,961)	(27,528)	(24,759)	(10.1)	3.3	(28,079)	(11.8)
EBITDA	12,608	16,280	29,056	78.5	130.5	21,379	35.9
EBITDAM (%)	3.0	3.0	6.1	-	-	4.0	-
Depreciation and amort.	(6,160)	(6,671)	(6,804)	2.0	10.5	(7,004)	(2.9)
EBIT	6,448	9,609	22,252	131.6	245.1	14,375	54.8
EBITM (%)	1.5	1.8	4.7	-	-	2.7	-
Other income	5,469	5,703	5,194	(8.9)	(5.0)	5,703	(8.9)
Interest expenses	(1,164)	(1,430)	(1,563)	9.3	34.3	(1,573)	(0.6)
Extraordinary/exceptional item	-	-	-	-	-	-	-
Profit before tax	10,753	13,882	25,882	86.4	140.7	18,505	39.9
Tax expenses	(3,741)	(4,636)	(8,535)	84.1	128.1	(6,107)	39.8
Effective tax rate (%)	34.8	33.4	33.0	-	-	33.0	-
Reported net profit	7,012	9,246	17,347	87.6	147.4	12,398	39.9
NPM (%)	1.7	1.7	3.7	-	-	2.3	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Key financials

Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Revenues	1,755,890	1,994,975	2,202,148	2,346,022	2,492,015
YoY (%)	(11.9)	13.6	10.4	6.5	6.2
EBITDA	79,657	106,463	110,765	120,989	130,926
YoY (%)	53.0	33.7	4.0	9.2	8.2
PAT	38,627	62,280	64,310	68,577	70,282
YoY (%)	41.3	61.2	3.3	6.6	2.5
EPS (Rs)	25.4	40.9	42.2	45.0	46.1
RoE (%)	21.0	28.0	24.5	22.4	20.1
EV/EBITDA (x)	7.5	5.4	5.4	5.4	5.5
P/E (x)	17.5	10.9	10.5	9.9	9.6

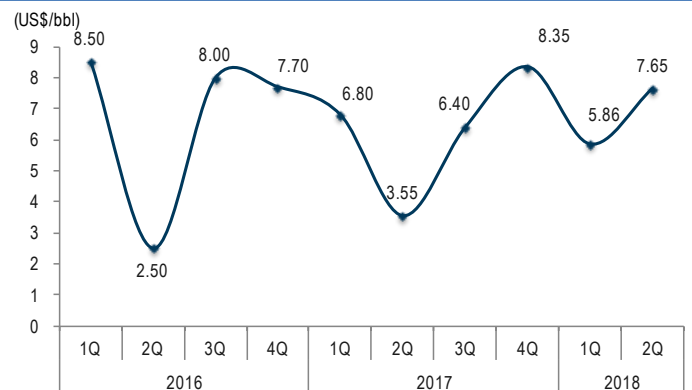
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Interest costs



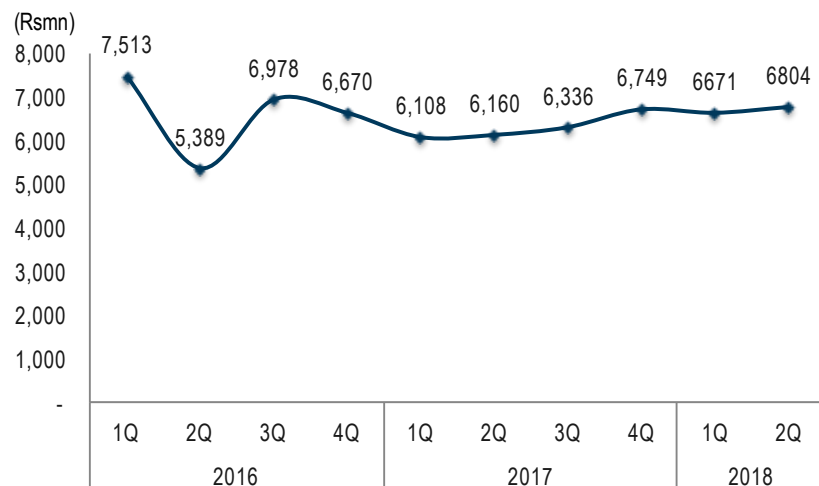
Source: Company, Nirmal Bang Institutional Equities Research

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)	FY16	FY17E	FY18E	FY19E	FY20E
Net sales	1,755,890	1,994,975	2,202,148	2,346,022	2,492,015
Growth YoY (%)	(11.9)	13.6	10.4	6.5	6.2
Operating costs	1,617,724	1,827,077	2,026,877	2,157,301	2,289,971
Staff expenses	23,145	24,303	25,518	26,794	28,133
Other expenses	35,364	37,132	38,988	40,938	42,985
EBITDA	79,657	106,463	110,765	120,989	130,926
EBITDA (%)	4.5	5.3	5.0	5.2	5.3
% growth	53.0	33.7	4.0	9.2	8.2
Depreciation	26,803	25,246	26,330	29,411	34,284
EBIT	52,854	81,217	84,435	91,579	96,643
EBIT (%)	3.0	4.1	3.8	3.9	3.9
Net interest expenses	5,818	2,980	2,175	3,503	6,637
Other income	14,282	14,857	13,868	14,431	15,051
Other adjustments	3,937	-	-	-	-
Earnings before tax	57,381	93,093	96,128	102,507	105,056
Tax-total	18,753	30,814	31,818	33,930	34,773
Rate of tax (%)	32.7	33.1	33.1	33.1	33.1
Net profit	38,627	62,280	64,310	68,577	70,282
% growth	41.3	61.2	3.3	6.6	2.5
EPS (FD)	25	41	42	45	46
% growth	41.3	61.2	3.3	6.6	2.5
DPS	8	13	13	15	15
Payout ratio (%)	36.4	37.9	36.7	37.9	37.0
Dividend on equity shares	11,683	20,318	20,318	22,350	22,350
Tax on dividend	2,378	3,296	3,296	3,626	3,626

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Share capital	3,390	10,159	10,159	10,159	10,159
Reserves and surplus	180,171	212,068	252,764	295,366	339,673
Net worth	183,561	222,227	262,923	305,525	349,832
Loans	213,368	212,118	245,118	321,118	391,118
Deferred tax liability	48,105	49,105	50,105	51,105	52,105
Capital employed	445,033	483,449	558,145	677,747	793,054
Net fixed assets	353,227	387,101	427,271	528,360	634,576
Investments	60,090	60,590	61,090	61,590	62,090
Current assets, loans	291,392	317,389	347,664	376,201	392,932
Inventories	127,091	128,928	141,621	151,994	159,277
Debtors	41,927	47,635	52,582	56,018	59,504
Cash and bank	70,245	88,196	100,331	114,559	120,022
Others	52,130	52,630	53,130	53,630	54,130
Less: Current liabilities	259,676	281,631	277,879	288,404	296,544
Current liabilities	238,108	243,608	239,757	247,709	255,765
Provisions	21,568	38,022	38,122	40,695	40,779
Net current assets	(38,528)	(52,437)	(30,547)	(26,762)	(23,634)
Total capital employed	445,033	483,449	558,145	677,747	793,054

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: Cash flow

Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Profit after tax	38,627	62,280	64,310	68,577	70,282
Depreciation	26,594	24,746	25,830	28,911	33,784
Other income	(14,282)	(14,857)	(13,868)	(14,431)	(15,051)
Interest	5,818	2,980	2,175	3,503	6,637
Working cap changes	(6,184)	4,357	(21,891)	(6,146)	(3,128)
Others	3,304	999	1,000	1,000	1,000
Operating cash flow	53,878	80,505	57,556	81,413	93,524
Capex	(52,762)	(58,620)	(66,000)	(130,000)	(140,000)
Investments	(645)	(500)	(500)	(500)	(500)
Other income	14,282	14,857	13,868	14,431	15,051
Cash flow from investments	(39,125)	(44,263)	(52,632)	(116,069)	(125,449)
Equity	-	-	-	-	-
Debt	10,014	(1,250)	33,000	76,000	70,000
Interest expenses	(5,818)	(2,980)	(2,175)	(3,503)	(6,637)
Dividends	(9,985)	(14,061)	(23,614)	(23,614)	(25,975)
Cash flow from financing	(5,790)	(18,291)	7,211	48,883	37,387
Total cash generation	8,964	17,951	12,135	14,228	5,463
Opening cash balance	61,281	70,245	88,196	100,331	114,559
Closing cash balance	70,245	88,196	100,331	114,559	120,022

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Key ratios

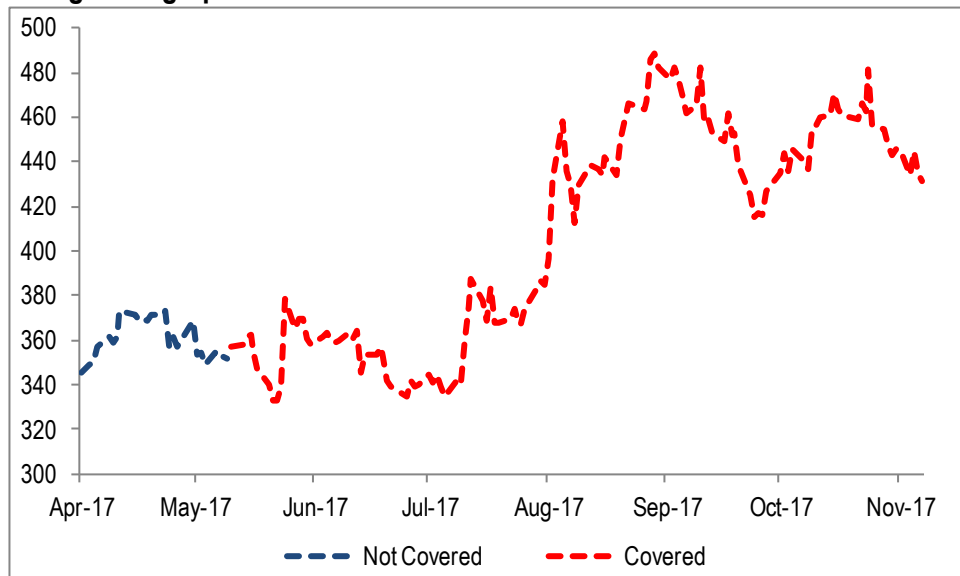
Y/E March (Rsmn)	FY16	FY17E	FY18E	FY19E	FY20E
Profitability and return ratios (%)					
EBITDA margin (%)	4.5	5.3	5.0	5.2	5.3
EBIT margin (%)	3.0	4.1	3.8	3.9	3.9
Net profit margin (%)	2.2	3.1	2.9	2.9	2.8
RoE (%)	21.0	28.0	24.5	22.4	20.1
RoCE (%)	16.2	23.5	20.7	17.9	15.6
Working capital and liquidity ratios					
Receivable (days)	9	9	9	9	9
Inventory (days)	26	24	23	24	23
Payable (days)	15	17	17	17	17
Current ratio (x)	0.9	0.8	0.9	1.0	1.0
Quick ratio(x)	0.5	0.5	0.6	0.6	0.6
Valuation ratios					
EV/sales (x)	0.3	0.3	0.3	0.3	0.3
EV/EBITDA (x)	7.5	5.4	5.4	5.4	5.5
P/E (x)	17.5	10.9	10.5	9.9	9.6
P/BV (x)	2.5	2.0	1.7	1.5	1.3

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
10 November 2017	Sell	431	321

Rating track graph



Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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