

# HPCL

12 February 2018

Reuters: HPCL.BO; Bloomberg: HPCL IN

## Strong Earnings Growth Driven By Inventory Gains

Hindustan Petroleum Corporation or HPCL's 3QFY18 profit increased 22.6% YoY and 12.4% QoQ to Rs19.5bn because of: 1) Higher gross refining margin or GRM of 9 (US\$/bbl) in 3QFY18 versus 7.66 (US\$/bbl) in 2QFY18 and 6.60 (US\$/bbl) in 3QFY17. 2) Increase in domestic sales from 8.37mmt in 2QFY18 to 9.23mmt in 3QFY18. 3) Pipeline throughput at 5.17mmt in 3QFY18 versus 4.47mmt in 3QFY17, resulting in an increase of 16% YoY. 4) Staff costs declining 5.4% QoQ to Rs6.7bn. The rise in earnings was capped because of the decline in refinery throughput from 4.66mmt in 3QFY17 to 4.52mmt in 3QFY18. We have rolled forward out SOTP-based valuation of HPCL to FY20E earnings with a target price of Rs358 (from Rs321 earlier) and retained our Sell rating on it.

**Revenue growth exceeds expectation on higher domestic sales, rise in GRM:** HPCL posted revenues of Rs575bn, an increase of 18.4% YoY and 20.9% QoQ. Higher revenues were because of: 1) Higher sales in domestic market at 9.23mmt, up 10% QoQ. 2) Increase in pipeline throughput from 4.47mmt in 3QFY17 to 5.17mmt in 3QFY18. 3) Higher GRM at 9 (US\$/bbl) versus 7.66 (US\$/bbl) in 2QFY18 and 6.60 (US\$/bbl) in 3QFY17. However, the refinery segment disappointed with a throughput of 4.52mmt in 3QFY18 versus 4.66mmt in 3QFY17.

**Inventory gains lead to higher GRM:** HPCL reported EBITDA of Rs31.6bn for 3QFY18, an increase of 8.7% QoQ and 3.9% YoY. Positive EBITDA performance was primarily because of: 1) Inventory gains, as GRM rose from 7.66(US\$/bbl) in 2QFY18 to 9(US\$/bbl) in 3QFY18. Inventory gains in 3QFY18 can be attributed to the following events: a) Repair to Britain's Forties crude oil pipeline in North Sea which was closed as cracks were revealed on routine inspection. The pipeline carried around 450,000bbl a day of Forties crude oil to Britain. Forties pipeline shutdown took place on 11 December 2017, but it is now fully operational. b) A pipeline supplying crude oil to Es Sider Port was blown up in Libya causing a decline in supply by 90,000bbl per day. c) OPEC (Organisation of Petroleum Exporting Countries) extended the 1.8mn bbl per day production cut scheduled from March 2018 to the end of 2018. 2) Staff costs at Rs6.7bn declined 5.4% QoQ.

**Finance costs decline sequentially:** Finance costs at Rs0.9bn fell 42.5% QoQ and increased 70% YoY. The decline in finance costs aided HPCL to achieve profit after tax of Rs19.5bn, up 22.6% YoY and 12.4% QoQ.

**Roll forward out SOTP-based valuation to FY20E earnings; retain Sell rating:** 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 likely and a decline in RoE and RoCE, the stock will get de-rated. We have retained Sell rating on HPCL and rolled forward our SOTP-based valuation to FY20E earnings with a target price of Rs358 (from Rs321 earlier).

## SELL

**Sector:** Oil & Gas

**CMP:** Rs393

**Target Price:** Rs358

**Downside:** 9%

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### Key Data

Current Shares O/S (mn)	1,523.8
Mkt Cap (Rsbn/US\$bn)	600.8/9.3
52 Wk H / L (Rs)	493/327
Daily Vol. (3M NSE Avg.)	4,571,948

### Price Performance (%)

	1 M	6 M	1 Yr
HPCL	(5.5)	(8.2)	2.5
Nifty Index	(1.6)	5.6	19.2

Source: Bloomberg

Y/E March (Rsmn)	3QFY18	2QFY18	QoQ (%)	3QFY17	YoY (%)	3QFY18E	Var. (%)
<b>Net sales</b>	<b>574,743</b>	475,225	<b>20.9</b>	485,556	<b>18.4</b>	500,770	<b>14.8</b>
Cost of goods	(508,701)	(414,332)	<b>22.8</b>	(424,074)	<b>20.0</b>	(437,880)	<b>16.2</b>
Employee benefits expenses	(6,699)	(7,081)	<b>(5.4)</b>	(6,104)	<b>9.7</b>	(7,223)	<b>(7.2)</b>
Other expenses	(27,757)	(24,759)	<b>12.1</b>	(27,345)	<b>1.5</b>	(25,254)	<b>9.9</b>
<b>EBITDA</b>	<b>31,585</b>	<b>29,053</b>	<b>8.7</b>	<b>28,033</b>	<b>12.7</b>	<b>30,413</b>	<b>3.9</b>
<b>EBITDAM (%)</b>	<b>5.5</b>	<b>6.1</b>	-	<b>5.8</b>	-	<b>6.1</b>	-
Depreciation and amortisation	(6,799)	(6,804)	<b>(0.1)</b>	(6,336)	<b>7.3</b>	(6,940)	<b>(2.0)</b>
<b>EBIT</b>	<b>24,786</b>	<b>22,249</b>	<b>11.4</b>	<b>21,698</b>	<b>14.2</b>	<b>23,473</b>	<b>5.6</b>
<b>EBITM (%)</b>	<b>4</b>	<b>5</b>	-	<b>4</b>	-	<b>5</b>	-
Other income	4,743	5,194	<b>(8.7)</b>	2,878	<b>(64.8)</b>	5,194	<b>(8.7)</b>
Interest expenses	(899)	(1,563)	<b>(42.5)</b>	(530)	<b>69.7</b>	(1,642)	<b>(45.3)</b>
Extraordinary/exceptional items	-	-	-	-	-	-	-
<b>Profit before tax</b>	<b>28,631</b>	<b>25,879</b>	<b>10.6</b>	<b>24,046</b>	<b>19.1</b>	<b>27,025</b>	<b>5.9</b>
Tax expenses	(9,134)	(8,535)	-	(8,143)	-	(8,918)	-
<b>Effective tax rate (%)</b>	<b>32</b>	<b>33</b>	-	<b>34</b>	-	<b>33</b>	-
<b>PAT</b>	<b>19,497</b>	<b>17,347</b>	<b>12.4</b>	<b>15,903</b>	<b>22.6</b>	<b>18,107</b>	<b>7.7</b>
<b>NPM (%)</b>	<b>3.4</b>	<b>3.7</b>	-	<b>3.3</b>	-	<b>3.6</b>	-

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 1: Key financials

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Revenues	1,773,943	1,867,097	2,202,148	2,346,022	2,492,015
YoY (%)	(11.0)	5.3	17.9	6.5	6.2
EBITDA	76,330	102,630	110,765	120,989	130,926
Margin (%)	4.3	5.5	5.0	5.2	5.3
PAT	37,262	62,088	64,310	68,577	70,282
YoY (%)	36.3	66.6	3.6	6.6	2.5
EPS (Rs)	24.4	40.7	42.2	45.0	46.1
RoE (%)	20.7	30.5	24.5	22.4	20.1
EV/EBITDA (x)	10.0	7.1	6.8	6.8	6.7
P/E (x)	16.4	9.8	9.5	8.9	8.7

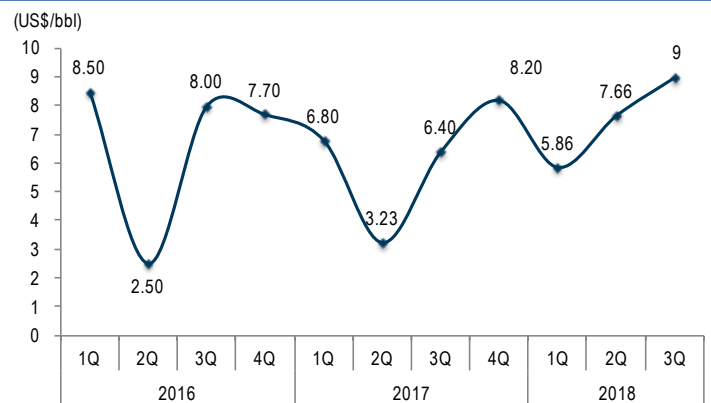
Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Interest costs



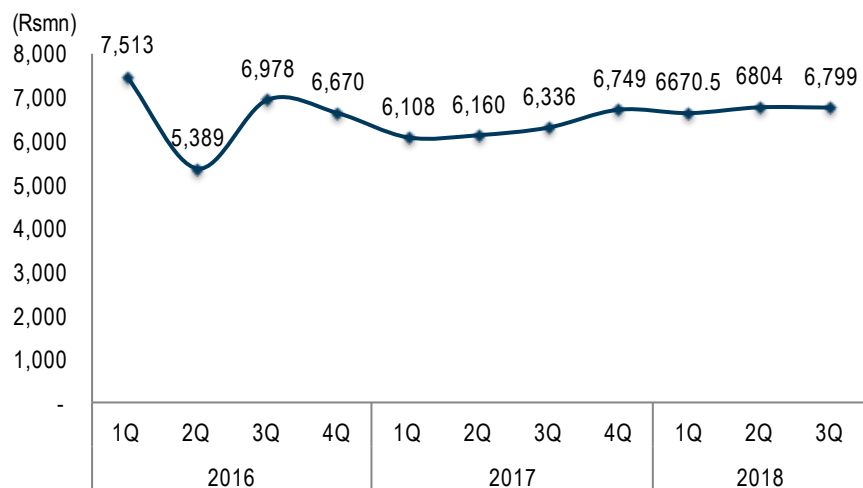
Source: Company, Nirmal Bang Institutional Equities Research

## 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	FY17	FY18E	FY19E	FY20E
<b>Net sales</b>	<b>1,773,943</b>	<b>1,867,097</b>	<b>2,202,148</b>	<b>2,346,022</b>	<b>2,492,015</b>
<b>% growth</b>	<b>(11.0)</b>	<b>5.3</b>	<b>17.9</b>	<b>6.5</b>	<b>6.2</b>
Operating costs	1,621,334	1,687,473	2,026,877	2,157,301	2,289,971
Staff expenses	23,213	29,461	25,518	26,794	28,133
Other expenses	53,066	47,533	38,988	40,938	42,985
<b>EBITDA</b>	<b>76,330</b>	<b>102,630</b>	<b>110,765</b>	<b>120,989</b>	<b>130,926</b>
<b>EBITDA (%)</b>	<b>4.3</b>	<b>5.5</b>	<b>5.0</b>	<b>5.2</b>	<b>5.3</b>
<b>% growth</b>	<b>46.6</b>	<b>34.5</b>	<b>7.9</b>	<b>9.2</b>	<b>8.2</b>
Depreciation	26,532	25,353	26,330	29,411	34,284
EBIT	49,798	77,277	84,435	91,579	96,643
<b>EBIT (%)</b>	<b>2.8</b>	<b>4.1</b>	<b>3.8</b>	<b>3.9</b>	<b>3.9</b>
Net interest expenses	6,536	5,357	2,175	3,503	6,637
Other income	14,505	18,288	13,868	14,431	15,051
Other adjustments	-	-	-	-	-
Earnings before tax	57,766	90,208	96,128	102,507	105,056
Tax-total	20,505	28,120	31,818	33,930	34,773
Rate of tax (%)	35.5	31.2	33.1	33.1	33.1
<b>Net profit</b>	<b>37,262</b>	<b>62,088</b>	<b>64,310</b>	<b>68,577</b>	<b>70,282</b>
<b>% growth</b>	<b>36.3</b>	<b>66.6</b>	<b>3.6</b>	<b>6.6</b>	<b>2.5</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 7: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	3,390	10,163	10,159	10,159	10,159
Reserves and surplus	176,308	193,311	252,764	295,366	339,673
Net worth	179,698	203,474	262,923	305,525	349,832
Loans	200,807	174,654	245,118	321,118	391,118
Deferred tax liability	49,194	58,956	50,105	51,105	52,105
<b>Capital employed</b>	<b>429,698</b>	<b>437,084</b>	<b>558,145</b>	<b>677,747</b>	<b>793,054</b>
Net fixed assets	349,603	379,424	427,271	528,360	634,576
Investments	55,871	58,099	61,090	61,590	62,090
Current assets, loans	15,462	17,959	347,664	376,201	392,932
Inventories	132,114	185,763	141,621	151,994	159,277
Debtors	37,580	40,642	52,582	56,018	59,504
Cash and bank	50,152	51,424	100,331	114,559	120,022
Others	55,010	51,329	53,130	53,630	54,130
Less: Current liabilities	266,095	347,555	277,879	288,404	296,544
Current liabilities	249,629	323,470	239,757	247,709	255,765
Provisions	16,466	24,085	38,122	40,695	40,779
Net current assets	8,762	(18,397)	(30,547)	(26,762)	(23,634)
<b>Total capital employed</b>	<b>429,698</b>	<b>437,084</b>	<b>558,145</b>	<b>677,747</b>	<b>793,054</b>

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 6: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Profit after tax	37,262	62,088	64,310	68,577	70,282
Depreciation	26,532	25,353	25,830	28,911	33,784
Other income	(4,671)	(4,471)	(13,868)	(14,431)	(15,051)
Interest	6,536	5,357	2,175	3,503	6,637
Working cap changes	(14,397)	6,120	18,109	(6,146)	(3,128)
Others	16,569	5,381	1,000	1,000	1,000
<b>Operating cash flow</b>	<b>67,831</b>	<b>99,827</b>	<b>97,556</b>	<b>81,413</b>	<b>93,524</b>
Capex	(46,942)	(58,518)	(66,000)	(130,000)	(140,000)
Investments	(526)	947	(500)	(500)	(500)
Other income	3,925	4,473	13,868	14,431	15,051
<b>Cash flow from investments</b>	<b>(43,543)</b>	<b>(53,098)</b>	<b>(52,632)</b>	<b>(116,069)</b>	<b>(125,449)</b>
Equity	-	-	-	-	-
Debt	(13,077)	6,816	98,524	76,000	70,000
Interest expenses	(6,749)	(5,219)	(2,175)	(3,503)	(6,637)
Dividends	(17,359)	(41,750)	(23,614)	(23,614)	(25,975)
<b>Cash flow from financing</b>	<b>(37,186)</b>	<b>(40,153)</b>	<b>72,735</b>	<b>48,883</b>	<b>37,387</b>
Total cash generation	(12,899)	6,576	117,659	14,228	5,463
Opening cash balance	(11,007)	(23,905)	(17,329)	100,331	114,559
Closing cash balance*	(23,905)	(17,329)	100,331	114,559	120,022

Source: Company, Nirmal Bang Institutional Equities Research

\*Note: Cash closing and opening balances are negative as reported by the company (availed cash credit facility)

### Exhibit 8: Key ratios

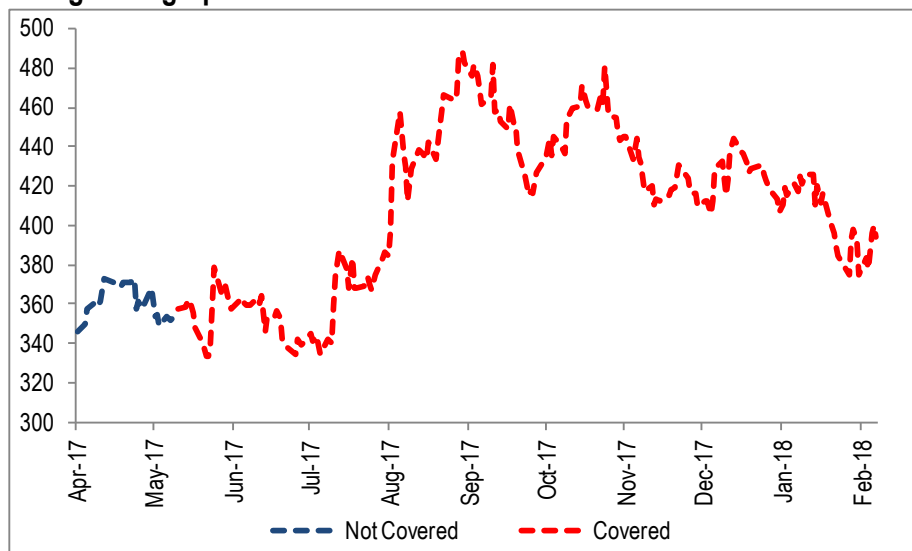
Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
<b>Profitability and return ratios (%)</b>					
EBITDA margin (%)	4.3	5.5	5.0	5.2	5.3
EBIT margin (%)	2.8	4.1	3.8	3.9	3.9
Net profit margin (%)	2.1	3.3	2.9	2.9	2.8
RoE (%)	20.7	30.5	24.5	22.4	20.1
RoCE (%)	15.1	23.7	20.7	17.9	15.6
<b>Working capital and liquidity ratios</b>					
Receivable (days)	8	8	9	9	9
Inventory (days)	30	40	26	26	25
Payable (days)	21	27	17	17	17
Current ratio (x)	1.0	0.9	0.9	1.0	1.0
Quick ratio(x)	0.5	0.4	0.6	0.6	0.6
<b>Valuation ratios</b>					
EV/sales (x)	0.4	0.4	0.3	0.3	0.35
EV/EBITDA (x)	10.0	7.1	6.8	6.8	6.73
P/E (x)	16.4	9.8	9.5	8.9	8.7
P/BV (x)	3.4	3.0	2.3	2.0	1.7

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
12 February 2018	Sell	393	358

## Rating track graph



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BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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