

# Hindustan Petroleum Corporation

23 May 2018

Reuters: HPCL.BO; Bloomberg: HPCL IN

## Higher Expenses and Lower GRM Lead To Subdued Earnings

Hindustan Petroleum Corporation or HPCL's 4QFY18 profit declined 10.5% YoY and 3.9% QoQ to Rs17.5bn because of: 1) Weak gross refining margin or GRM of US7.1\$/bbl in 4QFY18 versus US9\$/bbl in 3QFY18 and US7.9\$/bbl in 4QFY17. 2) Other expenses at Rs33.5bn increased 37.5% YoY and 20.7% QoQ. 3) Increase in employee benefit expenses by 16.7% QoQ to Rs7.8bn. However, a further decline in earnings was mitigated by: 1) Rise in product sales from 8.76mmt in 4QFY17 to 9.39mmt in 4QFY18, up 7% YoY. 2) Rise in refinery throughput from 4.52mmt in 3QFY18 to 4.63mmt in 4QFY18.

Recent inability of oil marketing companies or OMCs to increase product prices amid a rising crude oil price environment has raised concerns about the ability of OMCs to hike prices to compensate for the rise in crude oil prices. This also raises concerns on the pricing freedom of OMCs to set prices based on the given formula. Inability to increase prices is expected to negatively impacting their marketing margins. We have revised our SOTP-based valuation of HPCL and retained Sell rating on it with a revised target price of Rs272 (from Rs358 earlier).

**Revenues increase primarily driven by higher crude oil prices and product sales:** HPCL posted revenues of Rs666bn for the quarter, an increase of 13.4% YoY and 5.7% QoQ. Higher revenues were because of: 1) Rise in average crude oil price from US\$53/bbl in 4QFY17 and US\$59/bbl in 3QFY18 to US\$64/bbl in 4QFY18. 2) Product sales (domestic + exports) were at 9.39mmt, up 7% YoY and 2% QoQ. However, the refinery segment reported a flat throughput of 4.63mmt on YoY basis and an increase of 2.4% on QoQ basis.

**Weak GRM and higher expenses lead to disappointing EBITDA performance:** HPCL reported EBITDA of Rs29bn for 4QFY18, a decline of 7.5% QoQ and an increase of 1.3% YoY. Subdued EBITDA performance was primarily because of: 1) Weak GRM at US7.1\$/bbl in 4QFY18 versus US9\$/bbl in 3QFY18 and US7.66\$/bbl in 4QFY17. 2) Other expenses at Rs33.5bn rose 37.5% YoY and 20.7% QoQ. 3) Employee benefit expenses were up 16.7% QoQ.

**Decline in other income and rise in depreciation adds to pressure on earnings:** Depreciation and amortisation expenses at Rs7.2bn rose 7.5% YoY and 6.7% QoQ. Other income declined 15.3% YoY and 27.8% QoQ to Rs3.4bn in 4QFY18. Finance costs at Rs1.7bn rose 104.4% QoQ and declined 21.7% YoY. HPCL posted profit after tax of Rs17.5bn, down 3.9% YoY and 10.5% QoQ.

**Retain Sell rating with a revised target price of Rs272:** Given our concerns on the likely decline in GRM, increase in capex over the next five years, rise in interest costs and concerns over product pricing freedom, we expect the upside in earnings to be capped. We believe that with likely 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 revised target price of Rs272 (from Rs358 earlier).

## SELL

**Sector:** Oil & Gas

**CMP:** Rs312

**Target Price:** Rs272

**Downside:** 13%

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### Key Data

Current Shares O/S (mn)	1,523.8
Mkt Cap (Rsbn/US\$bn)	214.2/4.0
52 Wk H / L (Rs)	493/289
Daily Vol. (3M NSE Avg.)	5,259,010

### Price Performance (%)

	1 M	6 M	1 Yr
HPCL	(11.8)	22.6	66.6
Nifty Index	(0.2)	1.9	11.7

Source: Bloomberg

Y/E March (Rsmn)	4QFY18	3QFY18	QoQ (%)	4QFY17	YoY (%)	4QFY18E	Var. (%)
<b>Net sales</b>	<b>666,410</b>	<b>630,762</b>	<b>5.7</b>	<b>587,788</b>	<b>13.4</b>	<b>679,842</b>	<b>(2.0)</b>
Cost of goods	(595,851)	(564,720)	<b>5.5</b>	(523,387)	<b>13.8</b>	(616,978)	<b>(3.4)</b>
Employee benefits expenses	(7,821)	(6,699)	<b>16.7</b>	(11,161)	<b>(29.9)</b>	(7,367)	<b>6.2</b>
Other expenses	(33,512)	(27,757)	<b>20.7</b>	(24,380)	<b>37.5</b>	(25,749)	<b>30.1</b>
<b>EBITDA</b>	<b>29,226</b>	<b>31,585</b>	<b>(7.5)</b>	<b>28,860</b>	<b>1.3</b>	<b>29,748</b>	<b>(1.8)</b>
<b>EBITDAM (%)</b>	<b>4.4</b>	<b>5.0</b>	-	<b>4.9</b>	-	<b>4.4</b>	-
Depreciation and amortisation	(7,254)	(6,799)	<b>6.7</b>	(6,749)	<b>7.5</b>	(7,079)	2.5
<b>EBIT</b>	<b>21,973</b>	<b>24,786</b>	<b>(11.4)</b>	<b>22,111</b>	<b>(0.6)</b>	<b>22,669</b>	<b>(3.1)</b>
<b>EBITM (%)</b>	<b>3.3</b>	<b>3.9</b>	-	<b>3.8</b>	-	<b>3.3</b>	-
Other income	3,427	4,743	<b>(27.8)</b>	4,047	<b>(15.3)</b>	4,743	(27.8)
Interest expenses	(1,776)	(869)	<b>104.4</b>	(2,268)	<b>(21.7)</b>	(1,078)	64.7
<b>Profit before tax</b>	<b>23,624</b>	<b>28,661</b>	<b>(17.6)</b>	<b>23,890</b>	<b>(1.1)</b>	<b>26,334</b>	<b>(10.3)</b>
Tax expenses	(6,145)	(9,133)	-	(5,702)	-	(8,027)	-
<b>Effective tax rate (%)</b>	<b>26.01</b>	<b>31.87</b>	-	<b>23.87</b>	-	<b>30.48</b>	-
<b>PAT</b>	<b>17,479</b>	<b>19,528</b>	<b>(10.5)</b>	<b>18,188</b>	<b>(3.9)</b>	<b>18,307</b>	<b>(4.5)</b>
<b>NPM (%)</b>	<b>2.6</b>	<b>3.1</b>	-	<b>3.1</b>	-	<b>2.7</b>	-

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 1: Key financials

Y/E March (Rsmn)	FY16	FY17	FY18	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)	8.2	5.8	5.6	5.6	5.7
P/E (x)	12.7	7.6	7.4	7	6.8

Source: Company, Nirmal Bang Institutional Equities Research

## Exhibit 2: Interest costs



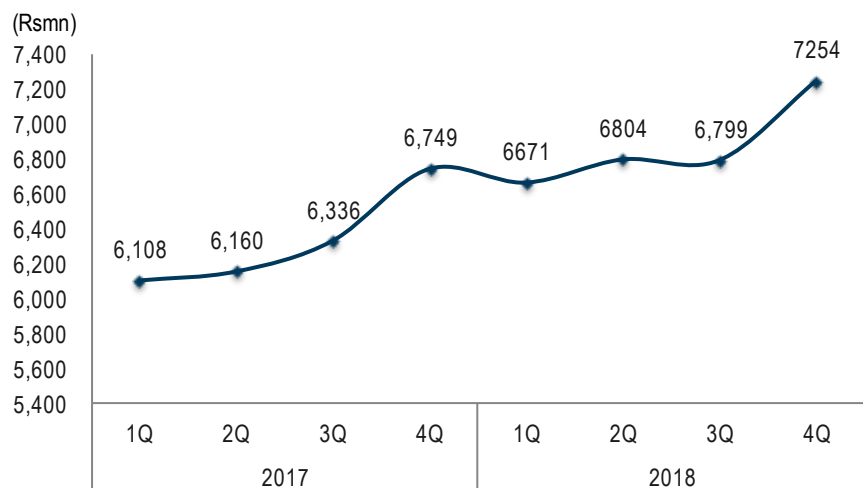
Source: Company, Nirmal Bang Institutional Equities Research

## 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	FY18	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	FY18	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	FY18	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

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

Source: Company, Nirmal Bang Institutional Equities Research

### Exhibit 8: Key ratios

Y/E March (Rsmn)	FY16	FY17	FY18	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	0.3	0.3	0.3	0.3
EV/EBITDA (x)	8.2	5.8	5.6	5.6	5.7
P/E (x)	12.7	7.6	7.4	7	6.8
P/BV (x)	2.6	2.4	1.8	1.6	1.4

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
23 May 2018	Sell	312	272

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### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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