INSTITUTIONAL RESEARCH

HPCL

Facing Headwinds

REDUCE

CMP *(as on 18 Mar 2024)*	INR 461
Target Price	INR 425
NIFTY	22,056

KEY CHANGES	OLD	NEW
Rating	REDUCE	REDUCE
Price Target	INR 495	INR 425
	FY24E	FY25E
EPS %	-3.2%	-14.5%

KEY STOCK DATA	
Bloomberg code	HPCL IN
No. of Shares (mn)	1,419
MCap (INR bn) / ($ mn)	654/7,999
6m avg traded value (INR mn)	3,814
52 Week high / low	INR 595/220

STOCK PERFORMANCE (%)	3M	6M	12M
Absolute (%)	21.6	79.4	90.1
Relative (%)	19.6	71.7	64.7

SHAREHOLDING PATTERN (%)	Sep-23	Dec-23
Promoters	54.90	54.90
FIs & Local MFs	22.61	21.28
FPIs	13.26	14.26
Public & Others	9.22	9.56
Pledged Shares	0.0	0.0

Source: BSE

Hindustan Petroleum Corporation (HPCL) stock corrected ~22% from its 52-week high and has underperformed the Sensex by ~23% over the last 1M. With most of its product profitability inversely correlated to the oil price, at the current FY25 EV/EBITDA multiple of 7.7x (a premium of ~31% to its 5-year average), we believe the risk-reward in the stock is unfavourable for investors. Lower rangebound oil prices and discount on Russian crude and not improvement in refining or marketing operations were the key reasons for HPCL's strong profitability over 9MFY24 and hence we believe it does not deserve a significant premium to historical valuation multiples. We reiterate our REDUCE recommendation on HPCL with a target price of INR 425/sh, owing to the risk of moderation in auto-fuel marketing margins and refining margins. We estimate EBITDA/PAT should decline by 13/19% CAGR over FY24-26E and believe the current multiples of 8x FY25E EPS, 7.7x FY25E EV/EBITDA and 1.3x FY25E P/Bv remain demanding.

- **Low oil price remains the most important determinant of profitability:** Crude oil price, the key driver of HPCL's profitability, has risen by ~18% to over USD 86/bbl from USD 73.5/bbl in 3M, which could adversely impact HPCL's marketing segment profitability, going ahead. Profits from as much as 60% of HPCL's products are determined by crude oil price – the lower the oil price, the higher the profitability (see Exhibit 6-8).
- **Refining margins likely to moderate:** We expect contribution from the refining segment for HPCL to decline owing to our expectation of a likely moderation in transportation fuel cracks from higher-than-average cracks spreads, driven by new refining capacities of >1.5mbpd in Nigeria, Middle East and Mexico ramping up over the next few months. Additionally, reportedly, the price discount offered on Russian crude is likely to decline from earlier USD 7-9/bbl to USD 3-3.5/bbl. Assuming a similar share of Russian crude as during 9MFY24, this reduction in price discount could imply an adverse impact of ~USD 2/bbl on the overall refining margins for HPCL. We expect its GRMs at USD 10.2/9.4/10.8 per bbl over FY24/25/26E compared to its 5-year average GRM of USD 5.7/bbl. Our sensitivity analysis suggests that every USD 1/bbl change in GRM impacts HPCL's FY24/FY25/26E EPS by 7.7/16.3/13.1% or INR 8.7/9.4/9.7 per share.
- **Pressure on marketing margins:** With crude oil prices rising to over ~USD 86/bbl and cut in retail petrol and diesel prices by INR 2/ltr ahead of the general elections in India, stronger than historical average auto fuel marketing margin is unsustainable. At current crude oil price, we estimate gross marketing margin on petrol and diesel at ~INR 1.1/ltr and INR -3.1/ltr respectively. Therefore, we factor in blended gross marketing margins for HPCL at INR 5.6/3.7/3.7 per litre for FY24/25/26E compared to its average gross marketing margin of INR 6/litre over 9MFY24 and 5-year average of INR 3.3/litre. Every INR 0.5/litre change in gross marketing margin impacts HPCL's FY24/25/26E EPS by 12.9/26.6/21.7% or INR 14.5/15.3/16.2 per share.
- **Change in estimates:** We cut our FY24/25/26 EPS estimates by 3.2/14.5/12.3% to INR 112.8/57.7/74.6 per share to factor in moderation in refining and gross marketing margins and higher depreciation, partially offset by lower other expenses, delivering a revised SOTP target price of INR 425/sh.
- **Valuation:** At the current market price, HPCL's valuation at 8x FY25E EPS, 1.3x FY25E P/Bv and 7.7x FY25E EV/EBITDA remains demanding given unfavourable risk reward. We maintain our REDUCE rating on HPCL with a target price of INR 425/sh as we value HPCL at 5.5x EV/E and investments at a 25% discount to CMP.

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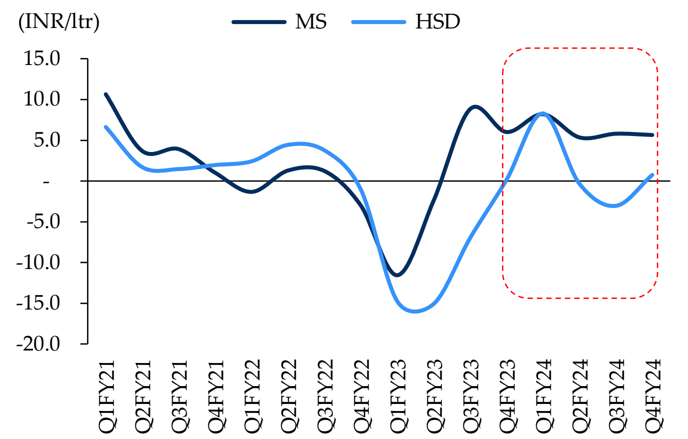
Exhibit 1: Financial summary (consolidated)

(INR bn)	FY22	FY23	FY24E	FY25E	FY26E
Net Sales	3,499	4,407	4,424	4,714	5,026
EBITDA	102	(72)	253	158	194
APAT	73	(70)	160	82	106
AEPS (INR)	51.4	(49.2)	112.8	57.7	74.6
P/E (x)	9.0	(9.4)	4.1	8.0	6.2
EV/EBITDA (x)	10.2	(17.6)	4.7	7.7	6.4
RoE (%)	18.4	(19.0)	42.5	17.9	20.3

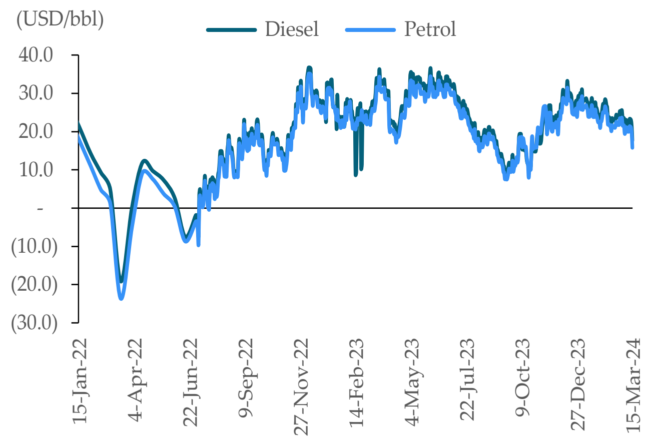
Source: Company, HSIE Research

Exhibit 2: Diesel gross marketing margins still trend below the near-term peak seen in Q1FY24



Source: Company, HSIE Research

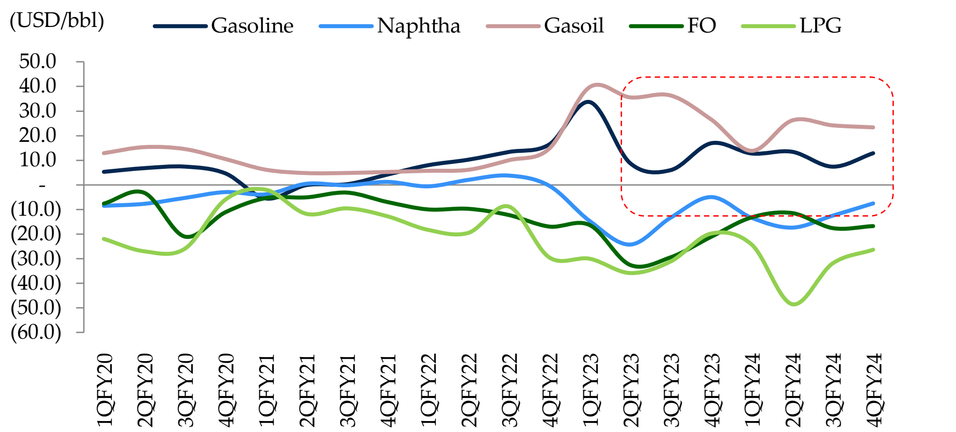
Exhibit 3: Total (refining + marketing) gross margins decline from the near-term peak seen in Dec-23



Source: PPAC, Bloomberg, HSIE Research

In Q4FY24TD, gasoil spreads moderate marginally to USD 23.6/bbl (vs USD 24.2/bbl in Q3FY24)

Exhibit 4: Gasoil cracks marginally moderate in Q4FY24TD QoQ



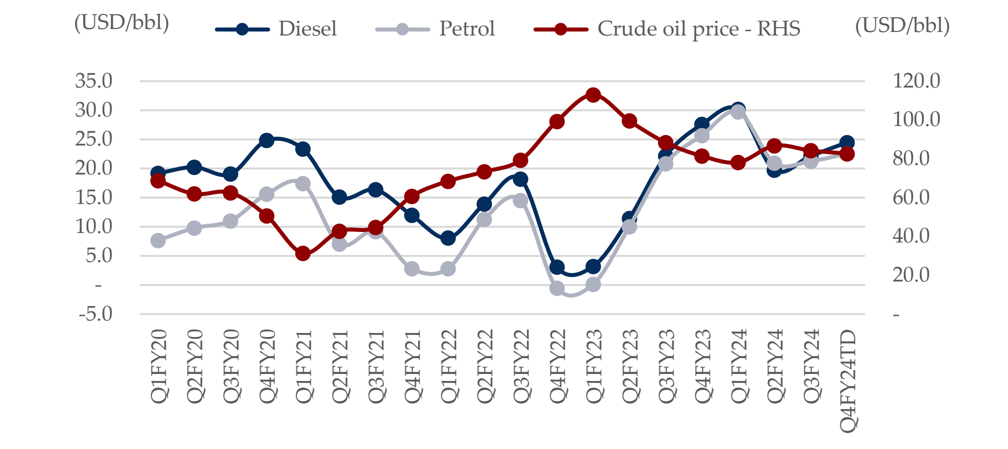
Source: Bloomberg, HSIE Research

Exhibit 5: New refining capacity to ramp up/commence operations in a few months

Refinery	Country	Refining Capacity (kbpd)	Status
Al-Zour	Kuwait	615	With the third of the three mini refineries coming online in Dec-23, the facility's refining capacity is expected to gradually increase to 615kbpd from 410kbpd.
Dangote	Nigeria	650	The company is scheduled to start production of diesel and aviation fuel by mid-January 2024 followed by premium motor spirit.
Duqm	Oman	230	Final work procedure of the Duqm Refinery at Duqm continues to progress, with the construction work rate exceeding 98 percent. In addition, the refinery's soft operations progress has reached more than 65 percent.
Olmeca	Mexico	340	Operational. Should ramp up to full capacity by Q1CY24
Yulong	China	400	Commercial operations expected in H2CY24
Port Harcourt	Nigeria	210	Expected to begin production in the Q1CY24

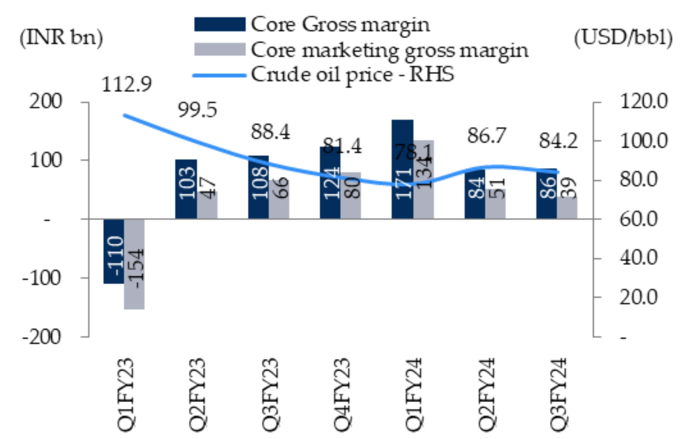
Source: Industry, HSIE Research

Exhibit 6: Combined refining+marketing margin is inversely related to crude oil prices…



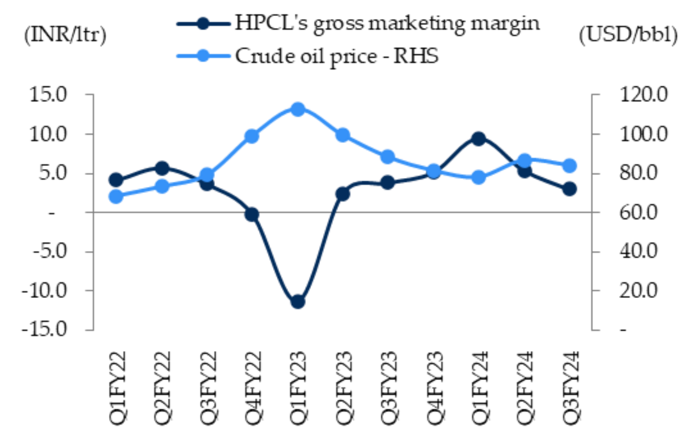
Source: Company, HSIE Research

Exhibit 7: …similarly, HPCL's gross marketing earnings and…



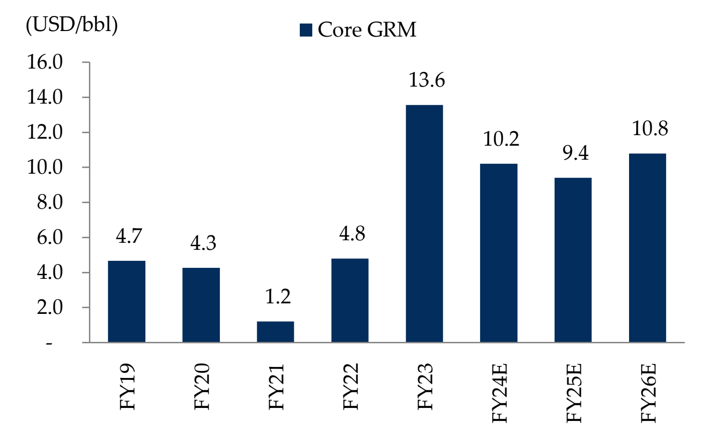
Source: Company, HSIE Research

Exhibit 8: …blended gross marketing margin per unit are too inversely related to crude oil price movement



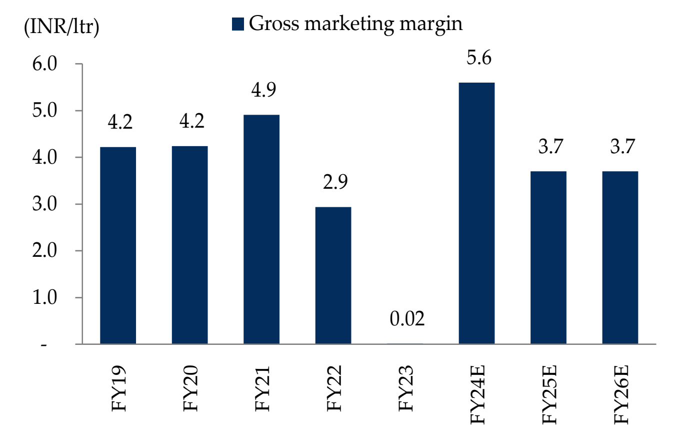
Source: Company, HSIE Research

Exhibit 9: We estimate GRMs of USD 10.2/9.4/10.8 per bbl…



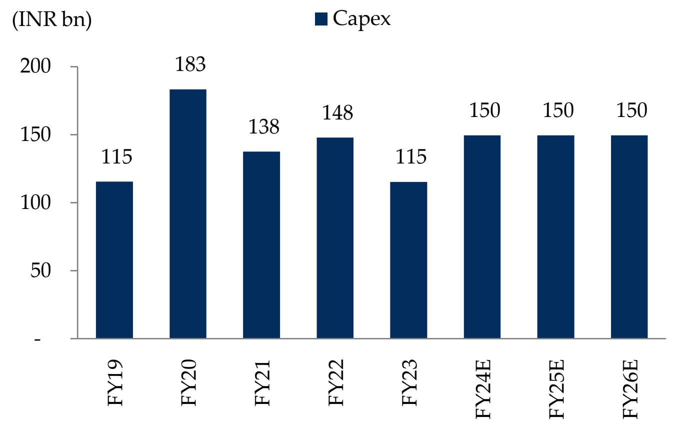
Source: Company, HSIE Research

Exhibit 10: …and gross marketing margins of INR 5.6/3.7/3.7 per litre over FY24/25/26



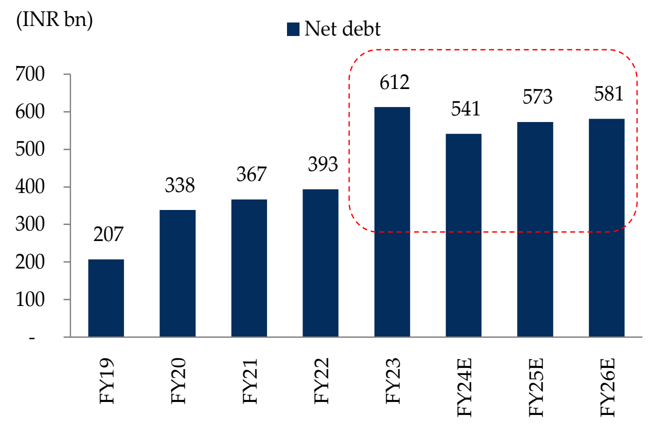
Source: Company, HSIE Research

Exhibit 11: High capex over FY24-26E...



Source: Company, HSIE Research

Exhibit 12: ...to keep net debt elevated over FY24-26E



Source: Company, HSIE Research

Exhibit 13: Change in estimates and target price

	CMP (INR)	RECO	TP (INR/sh)		Old EPS (INR/sh)			New EPS (INR/sh)			Est Change (%)		
			Old	New	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
HPCL	461	REDUCE	495	425	116.5	67.5	85.0	112.8	57.7	74.6	-3.2%	-14.5%	-12.3%

Source: NSE, HSIE Research

Exhibit 14: HSIE vs consensus estimates

(INR/sh)	HSIE				Bloomberg consensus				HSIE vs consensus			
	FY24E	FY25E	FY26E	TP	FY24E	FY25E	FY26E	TP	FY24E	FY25E	FY26E	TP
HPCL	112.8	57.7	74.6	425	111.4	71.4	77.9	496	1%	-19%	-4%	-14%

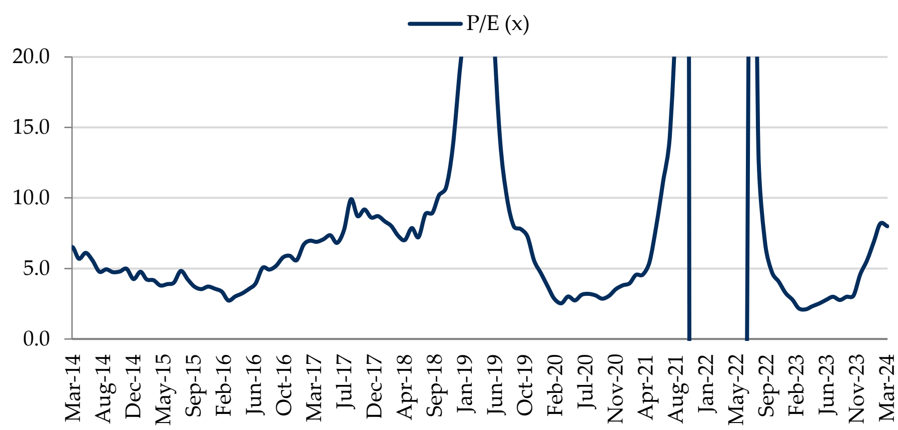
Source: Bloomberg, HSIE Research

Exhibit 15: Target price and earnings sensitivity

(Consolidated)	Target Price (INR/sh)	Target Price (% chg)	EPS (INR/sh)			Chg in EPS (%)		
			FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
HSIE	**425**	**-**	**112.8**	**57.7**	**74.6**	**-**	**-**	**-**
USD 1/bbl chg in GRMs	512	20.4	121.4	67.1	84.3	7.7	16.3	13.1
Rs0.5/ltr chg in gross marketing margin	558	31.0	127.3	73.0	90.8	12.9	26.6	21.7

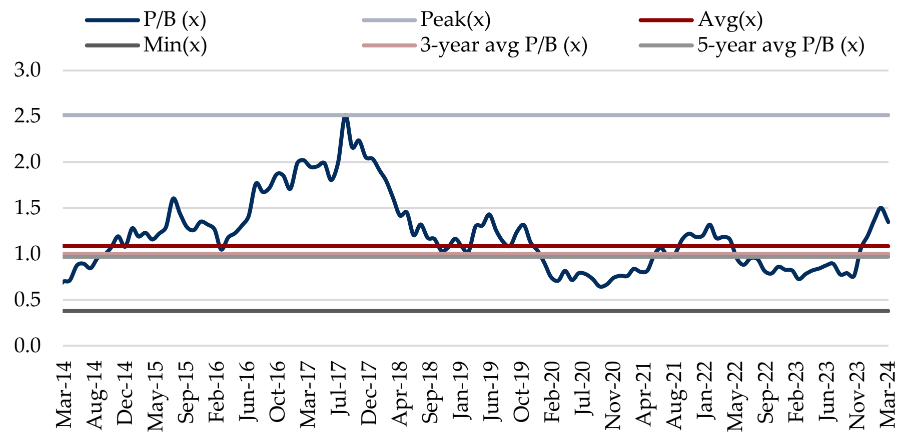
Source: HSIE Research

Exhibit 16: HPCL P/E chart



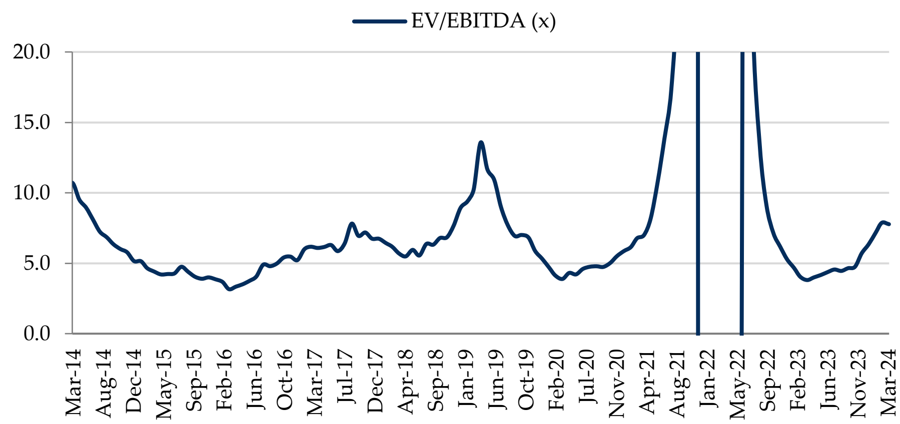
Source: NSE, Company, HSIE Research | Note: scales adjusted to reflect normalised data

Exhibit 17: HPCL P/Bv band chart



Source: NSE, Company, HSIE Research

Exhibit 18: HPCL EV/EBITDA chart



Source: NSE, Company, HSIE Research | Note: scales adjusted to reflect normalised data

Exhibit 19: Consolidated peer set comparison

Company name	CMP (INR/sh)	RECO	TP (INR/sh)	P/E (x)		P/B (x)		EV/EBITDA (x)		RoE (%)	
				FY25E	FY26E	FY25E	FY26E	FY25E	FY26E	FY25E	FY26E
Reliance Industries	2,879	ADD	2,740	25.0	23.8	2.3	2.1	12.4	11.7	9.7	9.4
Indian Oil Corporation	161	REDUCE	140	8.5	8.1	1.3	1.2	6.5	6.3	15.9	15.4
Bharat Petroleum Corporation	582	REDUCE	500	10.6	9.6	1.8	1.6	8.8	8.0	15.7	17.2
Hindustan Petroleum Corporation	461	REDUCE	425	8.0	6.2	1.3	1.2	7.7	6.4	17.9	20.3
SK Innovation co ltd	95	NR	NR	10.1	5.9	0.5	0.5	6.9	5.1	5.4	8.4
S-Oil Corp	59	NR	NR	6.6	6.4	0.9	0.8	5.1	4.9	14.3	13.3
Idemitsu Kosan Co ltd	7	NR	NR	8.2	8.6	0.8	0.8	7.2	7.9	11.1	9.4
Thai Oil PCL	2	NR	NR	8.5	5.8	0.8	0.7	9.0	6.6	9.1	12.2
Bangchak Corp PCL	1	NR	NR	5.6	5.3	0.7	0.7	3.8	3.8	13.3	12.8
Star Petroleum Refining	0.3	NR	NR	8.3	7.6	1.0	0.9	5.7	5.5	12.0	12.4
Formosa Petrochemical Corp	2	NR	NR	24.2	18.9	1.8	1.9	14.1	11.1	7.8	9.6
Channel Infrastructure NZ Ltd	1	NR	NR	18.1	17.1	1.1	1.1	9.1	9.3	8.7	6.9
Ampol (Caltex)	25	NR	NR	13.3	13.6	2.5	2.4	7.4	7.4	19.9	18.8
Valero Energy	164	NR	NR	10.0	12.1	2.0	1.9	6.2	7.2	17.8	14.3
Marathon Petroleum	194	NR	NR	12.1	13.0	2.9	2.8	7.0	7.6	21.3	20.0
Phillips 66	159	NR	NR	11.4	11.0	2.2	2.0	7.8	8.1	19.0	18.0

Source: Company, Bloomberg, HSIE Research | *Note: CMP for global refiners is in USD; FY25/26E is CY24/25 for global refiners

Financials (Consolidated)

Income Statement

(INR bn)	FY21	FY22	FY23	FY24E	FY25E	FY26E
Revenues	**2,332**	**3,499**	**4,407**	**4,424**	**4,714**	**5,026**
Growth (%)	(13.3)	50.0	25.9	0.4	6.5	6.6
Material Expenses	2,006	3,221	4,272	3,961	4,341	4,612
Employee Expenses	32	30	30	34	35	37
Other Operating Expenses	135	145	177	175	179	183
EBIDTA	**160**	**102**	**(72)**	**253**	**158**	**194**
EBIDTA Margin (%)	6.9	2.9	(1.6)	5.7	3.4	3.9
EBITDA Growth (%)	243.5	(36.0)	(170.4)	451.6	(37.5)	22.4
Depreciation	36	40	46	55	59	62
EBIT	**124**	**62**	**(118)**	**198**	**100**	**132**
Other Income (Incl EO)	26	24	15	18	20	21
Interest	10	10	22	24	25	26
PBT	**141**	**77**	**(125)**	**192**	**95**	**127**
Share of profit of JV/associates	1	15	25	22	15	14
PBT (incl profit of JV/associates)	**142**	**91**	**(100)**	**214**	**109**	**141**
Tax	35	18	(30)	54	28	36
PAT	**107**	**73**	**(70)**	**160**	**82**	**106**
EO (Loss) / Profit (Net Of Tax)	-	-	-	-	-	-
APAT	**107**	**73**	**(70)**	**160**	**82**	**106**
PAT growth (%)	3,374.9	(31.6)	(195.7)	329.2	(48.8)	29.2
AEPS	**75.1**	**51.4**	**(49.2)**	**112.8**	**57.7**	**74.6**
AEPS growth (%)	3,374.9	(31.6)	(195.7)	329.2	(48.8)	29.2

Source: Company, HSIE Research

Balance Sheet

(INR bn)	FY21	FY22	FY23	FY24E	FY25E	FY26E
SOURCES OF FUNDS						
Share Capital	15	14	14	14	14	14
Other equity	366	400	308	416	471	542
Total Shareholders' Funds	**381**	**414**	**323**	**431**	**486**	**556**
Long-term Debt	278	321	482	487	492	497
Short-term Debt	149	129	189	159	164	189
Total Debt	427	450	670	645	655	685
Deferred Taxes	55	60	29	30	32	33
Long Term Provisions & Others	212	37	41	41	41	42
TOTAL SOURCES OF FUNDS	**1,075**	**961**	**1,064**	**1,148**	**1,214**	**1,316**
APPLICATION OF FUNDS						
Net Block	509	581	684	801	903	996
CWIP	253	289	256	234	222	217
Investments	97	135	185	187	189	191
LT Loans & Advances	10	9	10	10	10	11
Other Non-current Assets	31	34	39	39	40	41
Total Non-current Assets	**900**	**1,049**	**1,174**	**1,271**	**1,365**	**1,456**
Inventories	288	355	296	263	288	305
Debtors	69	63	68	66	70	75
Cash & Equivalents	60	56	58	104	83	105
Other Current Assets	25	23	17	18	19	20
Total Current Assets	**442**	**497**	**440**	**451**	**460**	**505**
Creditors	178	265	229	250	274	291
Other Current Liabilities	89	321	321	324	336	354
Total Current Liabilities	**267**	**586**	**550**	**574**	**610**	**645**
Net Current Assets	**175**	**(88)**	**(110)**	**(123)**	**(150)**	**(140)**
TOTAL APPLICATION OF FUNDS	**1,075**	**961**	**1,064**	**1,148**	**1,214**	**1,316**

Source: Company, HSIE Research

Cash Flow Statement

(INR bn)	FY21	FY22	FY23	FY24E	FY25E	FY26E
Reported PBT	**142**	**91**	**(100)**	**214**	**109**	**141**
Non-operating & EO Items	(26)	(24)	(15)	(18)	(20)	(21)
Interest Expenses	10	10	22	24	25	26
Depreciation	36	40	46	55	59	62
Working Capital Change	32	259	24	58	6	11
Tax Paid	(36)	(14)	(0)	(53)	(26)	(34)
OPERATING CASH FLOW (a)	**158**	**363**	**(23)**	**281**	**153**	**185**
Capex	(138)	(148)	(115)	(150)	(150)	(150)
Free Cash Flow (FCF)	**20**	**215**	**(139)**	**131**	**3**	**36**
Investments	(6)	(38)	(50)	(2)	(2)	(2)
Non-operating Income	26	24	15	18	20	21
Others	0	(3)	(5)	(1)	(1)	(1)
INVESTING CASH FLOW (b)	**(117)**	**(164)**	**(156)**	**(134)**	**(133)**	**(132)**
Debt Issuance/(Repaid)	33	23	221	(25)	10	30
Interest Expenses	(10)	(10)	(22)	(24)	(25)	(26)
FCFE	**43**	**228**	**60**	**82**	**(11)**	**40**
Share Capital Issuance	(1)	(0)	-	-	-	-
Dividend	(39)	(24)	-	(52)	(27)	(35)
Others	(20)	(191)	(18)	0	0	0
FINANCING CASH FLOW (c)	**(37)**	**(202)**	**181**	**(101)**	**(41)**	**(31)**
NET CASH FLOW (a+b+c)	**4**	**(4)**	**2**	**46**	**(22)**	**22**
Closing Cash & Equivalents	60	56	58	104	83	105

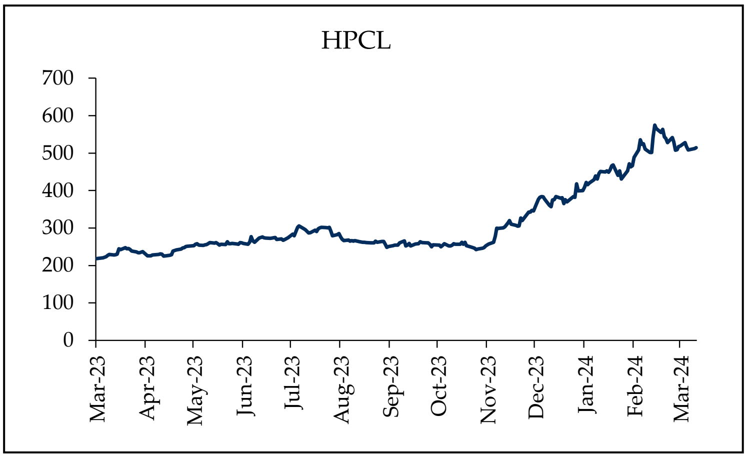
Source: Company, HSIE Research

Key Ratios

	FY21	FY22	FY23	FY24E	FY25E	FY26E
PROFITABILITY %						
EBITDA Margin	6.9	2.9	(1.6)	5.7	3.4	3.9
EBIT Margin	5.3	1.8	(2.7)	4.5	2.1	2.6
APAT Margin	4.6	2.1	(1.6)	3.6	1.7	2.1
RoE	30.9	18.4	(19.0)	42.5	17.9	20.3
Core RoCE	12.4	8.6	(10.5)	20.6	9.6	11.2
RoCE	11.0	7.9	(5.3)	16.1	8.4	9.9
EFFICIENCY						
Tax Rate %	25.1	24.1	24.1	28.0	29.1	28.0
Asset turnover (x)	3.5	4.5	4.8	4.0	3.7	3.5
Inventory (days)	45	37	24	22	22	22
Debtor (days)	11	7	6	5	5	5
Other Current Assets (days)	4	2	1	1	1	1
Payables (days)	32	30	20	23	23	23
Other Curr Liab & Prov (days)	14	33	27	27	26	26
Cash conversion cycle (days)	13	(17)	(15)	(21)	(20)	(20)
Net Debt/EBITDA (x)	2.3	3.8	(8.5)	2.1	3.6	3.0
Net D/E	1.0	1.0	1.9	1.3	1.2	1.0
Interest Coverage	12.8	6.3	(5.4)	8.1	4.0	5.0
PER SHARE DATA						
EPS (Rs)	75.1	51.4	(49.2)	112.8	57.7	74.6
CEPS (Rs)	100.7	79.6	(17.1)	151.7	99.0	118.0
DPS (Rs)	27.4	16.8	-	36.7	18.9	25.0
BV (Rs)	268.4	291.8	227.4	303.4	342.3	391.9
VALUATION						
P/E (x)	6.1	9.0	(9.4)	4.1	8.0	6.2
P/Cash EPS (x)	4.6	5.8	(27.0)	3.0	4.7	3.9
P/BV (x)	1.7	1.6	2.0	1.5	1.3	1.2
EV/EBITDA (x)	6.4	10.2	(17.6)	4.7	7.7	6.4
EV/Revenue (x)	0.4	0.3	0.3	0.3	0.3	0.2
OCF/EV (%)	15.4	34.6	(1.9)	23.5	12.5	15.0
FCFF/EV (%)	2.0	20.5	(10.9)	11.0	0.3	2.9
FCFE/M CAP (%)	6.6	34.9	9.2	12.5	(1.8)	6.1
Dividend Yield (%)	5.9	3.7	-	8.0	4.1	5.4

Source: Company, HSIE Research

1 Yr Price Movement



Rating Criteria

BUY: >+15% return potential

ADD: +5% to +15% return potential

REDUCE: -10% to +5% return potential

SELL: >10% Downside return potential

Disclosure:

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