December 15, 2023

# HPCL-Mittal Energy Limited: Rating reaffirmed; rated amount enhanced

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Long-term fund-based – Term loan** | 13,441.00 | 14,785.00 | [ICRA]AA+ (Stable); reaffirmed/assigned |
| **NCD 1** | 1,000.00 | 1,000.00 | [ICRA]AA+ (Stable); reaffirmed |
| **NCD 2** | 1,000.00 | 1,000.00 | [ICRA]AA+ (Stable); reaffirmed |
| **Total** | **15,441.00** | **16,785.00** | |

**Instrument details are provided in Annexure-I*

## Rationale

To arrive at the rating of HPCL-Mittal Energy Limited (HMEL), ICRA has taken a consolidated view of HMEL and HMPL because of the synergies between the two entities.

The rating reaffirmation factors in HMEL's strategic importance and its operational linkages with parent Hindustan Petroleum Corporation Limited (HPCL, [ICRA]AAA(Stable)/[ICRA]A1+). The rating action is also backed by the high complexity of its refinery, which aids its gross refining margins (GRMs), and the financial flexibility that has enabled the company to refinance most of the long-term debt, resulting in low debt repayments in the near to medium term and an elongated maturity profile. This, along with some deleveraging of the balance sheet through prepayment of existing debt, has resulted in the break-even GRM for HMEL to service its debt obligations and meet the operational expenses being lower than the actual GRMs posted. Moreover, HMEL's refinery is one of the most complex refineries in India with a Nelson Complexity Index (NCI) of 12.6, and its distillate yield is high with more than 50% of the product slate comprising diesel. Further, HMEL has commissioned the 1.2-MMTPA petrochemical plant which will result in downstream integration and revenue diversification, apart from providing a boost to the cash flow generation.

The GRMs have remained strong, resulting in healthy EBITDA generation for the company. While the GRMs have started to moderate now with some pressure in global product demand, they are likely to remain healthy. On the other hand, the petrochemical unit is largely stabilised, but the profitability is likely to remain depressed owing to weak spreads and the oversupply situation globally. ICRA notes that the two segments are likely to compensate each other in case of downturn in any one segment, resulting in annualised EBITDA generation of Rs. 7,500-8,500 crore, which, in the absence of any major capex plan would result in steady deleveraging of the balance sheet.

Further, HMEL is strategically important for HPCL to meet the demand for petroleum products in North India as HPCL does not have any refinery in this region. HMEL has a product offtake agreement with HPCL with a take-or-pay clause for its liquid products till CY2026 (with rollover option for another 5+5 years), mitigating the offtake risk. Additionally, HPCL has provided operational and financial support to HMEL in the past.

However, the ratings are tempered by the elevated debt levels on account of the recently commissioned large petrochemical project (1.2 MMTPA mixed feed cracker). Moreover, the petrochemical spreads have remained subdued owing to the excess capacities in Asia as well as subdued demand from China and Europe and the company remains exposed to the inherent volatility in petrochemical spreads.

The ratings also take into account the vulnerability of the company's profitability to the global refining margin cycle, import duty protection and INR-USD parity levels. The ratings also consider the asset concentration risk from being a single-location refinery and the sensitivity of profits to crude oil price volatility. The inventory losses/gains are likely to be higher for land-locked refineries like HMEL when there is a sharp fall/rise in crude oil prices because of the high inventory holdings.

Moreover, ICRA notes that there is a credit rating linked trigger with respect to the coupon step-up and step-down as well as a mandatory prepayment event, in case of a rating downgrade to a particular level for some of the NCDs of the company.

The Stable outlook reflects ICRA's expectation of adequate cash generation from the refinery and petrochemical operations, driven by healthy capacity utilisation of the refinery, to meet the debt obligations. While the debt levels are expected to remain elevated in the near term, they are expected to improve as the petrochemical project starts generating profits.

## Key rating drivers and their description

### Credit strengths

**Long and established track record of HPCL in domestic refining and marketing business** – The rating of HMEL considers the support from HPCL, the lead sponsor, which has a long track record in the refining segment and provides financial flexibility. HPCL, which has a strong credit profile, is also responsible for product marketing through a take-or-pay agreement with HMEL for liquid products and has set up the relevant marketing infrastructure to facilitate the same. HMEL is also of strategic importance for HPCL as the latter does not have any other refinery in the product-deficit northern region of the country.

**Favourable location of refinery in petroleum product-deficit and high-growth northern region –** HMEL's refinery is situated in the petroleum product-deficit northern region of the country, where demand has been growing faster than other parts of the country. There are only three refineries in the north — at Panipat in Haryana and Mathura in Uttar Pradesh, both owned by Indian Oil Corporation Limited (IOC, rated [ICRA]AAA(Stable)/[ICRA]A1+), and HMEL's unit Bathinda. The demand in this region surpasses the combined capacity of these refineries. Hence, the products are transported from the western part of the country. Post the commissioning of HMEL's refinery, the shortage has decreased in the northern region.

**Superior refining capability, high operational efficiency and healthy capacity utilisation in last couple of years –** HMEL's refinery can process mostly heavy and sour crude oil (average APIº: 26) and achieve a high distillate yield. As the demand for middle distillates is expected to increase in the domestic market, the configuration has been selected to maximise the yield. The refinery also has the flexibility to change its product slate marginally. Overall, the Nelson Complexity Index (NCI), a measurement of the complexity, is high at 12.6 for the refinery. The operational performance of the refinery has been healthy in the recent past, characterised by higher capacity utilisation levels (>100%). The throughput was 12.7 MMTPA in FY2023, indicating capacity utilisation of 113%, and remained high for H1 FY2024 as well.

**Downstream integration with commencement of petrochemical project –** The commencement of the 1.2-MMTPA petrochemical ethylene cracker plant in March 2023 helped HMEL to diversify its product portfolio, producing a range of petrochemical products. This diversification will reduce the company's reliance on traditional fuel products and expand its offerings to cater to different market demands. The new petrochemical plant will also generate additional revenue streams for the company. HMEL, being an integrated energy company, can leverage the synergy between its existing refining operations and the new petrochemical plant. By using the refinery's by-products as feedstock for the petrochemical plant, the company can optimise operational efficiency and cost-effectiveness.

**Healthy financial flexibility –** The rating factors in the heathy financial flexibility of HMEL, reflected in its ability to refinance its term loan obligations. Further, the company has demonstrated some deleveraging of the balance sheet owing to healthy accruals. The term debt repayments will remain low for FY2024, with a gradual increase, going forward.

### Credit challenges

**Large debt-funded capex for petrochemical project, which has faced cost and time overruns –** HMEL has commissioned a petrochemical project during Mar 2023 to diversify its product slate, which should reduce the exposure to the commodity cycles of petroleum products. The project is a 1.2-MMTPA (of ethylene) multi-feed cracker with fuel gas, naphtha and other petroleum outputs of the refinery as feedstocks, which witnessed cost and time overruns, which were funded through debt. However, healthy cash generation post strong refining margins have started the steady deleveraging of the balance sheet.

Moreover, the debt tied up for the petrochemical project has a long moratorium and repayment tenure, which provides comfort from a credit perspective.

**Vulnerability of profitability to volatility in refining margins and petrochemical spreads, USD-INR parity, import duty differentials –** The refining of crude oil is a capital-intensive industry and lumpy large capacity additions lead to cyclicality in GRMs globally. Being a deregulated sector, HMEL's profits are exposed to the international refining cycle. Besides, crude oil and most petroleum products are priced in US$/bbl or US$/MT, which along with significant foreign currency debt, makes the profits vulnerable to foreign currency movements (especially INR-USD levels). Further, the domestic refining industry, including HMEL, has duty protection due to the differential in the duties of finished petroleum products and crude oil, and any adverse regulatory development will negatively impact the profits. HMEL's refinery at Bathinda is land-locked, which makes it more vulnerable to crude oil price volatility as inventory losses/gains are likely to be higher for such refineries in a scenario of a sharp fall/rise in crude oil prices because of the high inventory holdings.

**Asset concentration risk as a single-location refinery** – HMEL has refining operations only at Bathinda, Punjab, and derives all its revenues from this single unit. The operations at one location expose it to asset concentration risks related to natural calamities, accident at the plant etc. Nonetheless, the risk is partly mitigated by various insurance covers that address these risks.

## Liquidity position: Adequate

The liquidity position of the company is expected to remain adequate with the capex cycle largely over and the presence of free cash balances of around Rs. 2,800 crore as on June 30, 2023 along with some cushion in the working capital limits.

## Rating sensitivities

**Positive factors –** The rating can be upgraded if there is a ramp-up of the petrochemical capacities, coupled with steady refining margins, that would lead to a healthy cash flow generation and translate into material deleveraging of the balance sheet.

**Negative factors –** Factors leading to a downward revision of the rating include weakening of the credit risk profile of HPCL, weakening of the linkages of HMEL with HPCL, and any significant deterioration in HMEL's standalone financial risk profile.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable rating methodologies** | Corporate Credit Rating Methodology<br>Rating Methodology for Refining and Marketing |
| **Parent/Group support** | **Parent: Hindustan Petroleum Corporation Limited**<br>The ratings take into account the parentage of HPCL as the parent has provided significant equity support in the past. HMEL is of strategic importance to the parent, given the take-or-pay offtake agreement for liquid products and the absence of an HPCL refinery in petroleum product-deficit northern India. |
| **Consolidation/Standalone** | The ratings are based on the consolidated financials of HMEL. |

## About the company

HPCL-Mittal Energy Limited (HMEL), incorporated as Guru Gobind Singh Refinery Limited (GGSRL) in 2000, is a joint venture between HPCL and Mittal Energy Investment Pte Ltd (MEIL, Singapore - a L. N. Mittal group company). Both the JV partners hold 48.99% stake each in the company, while the remaining 2.02% is held by financial institutions (IFCI – 0.96%, SBI – 0.65% and HDFC Life – 0.4%).

In February 2012, HMEL commercially commissioned a greenfield refinery complex with a 9-MMTPA capacity at Bathinda (Punjab) along with a captive power plant of 165 MW. The refinery is configured to process a wide range of crude, including heavy crude, and achieved EURO III/EURO IV specifications for auto fuels. In June 2017, HMEL completed the expansion of its refining capacity to 11.3 MMTPA from 9 MMTPA. The company has recently commissioned a 1.2-MMTPA ethylene cracker at its Bathinda facility.

To meet the crude receipt and storage facilities as well as to transport the crude for the company, its wholly-owned subsidiary - HPCL-Mittal Pipelines Ltd (HMPL) - set up a crude oil terminal (COT) and single point mooring (SPM) at Mundra port, Gujarat, and a cross-country pipeline to transport crude oil from Mundra to Bathinda.

### Key financial indicators (audited)

| HMEL Consolidated | FY2022 | FY2023 |
|---|---|---|
| **Operating income** | 59,105.2 | 78,040.4 |
| **PAT** | 1,257.6 | 4,898.6 |
| **OPBDIT/OI** | 10.9% | 13.4% |
| **PAT/OI** | 2.1% | 6.3% |
| **Total outside liabilities/Tangible net worth (times)** | 4.6 | 3.7 |
| **Total debt/OPBDIT (times)** | 5.3 | 3.7 |
| **Interest coverage (times)** | 6.5 | 3.7 |

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore*

### Status of non-cooperation with previous CRA: Not applicable

### Any other information: None

## Rating history for past three years

| | Instrument | Current rating (FY2024) | | | | | Chronology of rating history for the past 3 years | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | Type | Amount rated (Rs. crore) | Amount outstanding as on Sep 30, 2023 (Rs. crore) | Date & rating in FY2024 | | Date & rating in FY2023 | Date & rating in FY2022 | Date & rating in FY2021 | |
| | | | | | Dec 15, 2023 | Jul 28, 2023 | Jul 29, 2022 | Jul 30, 2021 | Mar 23, 2021 | Aug 24, 2020 |
| **1** | **Term loans** | Long term | 14,785.0 | 12,407.0 | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** |
| **2** | **Long term - Non-convertible debentures** | Long term | 2,000.0 | 2,000.0 | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** | **[ICRA]AA+ (Stable)** |
| **3** | **Long term - Non-convertible debentures** | Long term | - | -- | - | **[ICRA]AA+ (Stable); withdrawn** | **[ICRA]AA+ (Stable)** | - | - | - |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **4** | **Long term - Non-convertible debentures** | Long term | - | -- | - | - | **[ICRA]AA+ (Stable); withdrawn** | **[ICRA]AA+ (Stable)** | - | - |
| **5** | **Commercial paper programme** | Short term | - | -- | - | - | - | - | **[ICRA]A1+; withdrawn** | **[ICRA]A1+** |

## Complexity level of the rated instruments

| | Complexity Indicator |
|---|---|
| **Long-term fund-based – Term loan** | Simple |
| **Long-term – NCD** | Very Simple |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA’s website: Click Here

## Annexure I: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| - | **Term loans** | FY2018-FY2021 | 7-7.3% | FY2024-FY2028 | 14,785.0 | [ICRA]AA+(Stable) |
| **INE137K07042** | **Bond programme** | February 28, 2020 | 9.18% | February 28, 2030 | 1000.0 | [ICRA]AA+(Stable) |
| **INE137K07059** | **Bond programme** | September 3, 2020 | 7.15% | Sep 3, 2025 | 1000.0 | [ICRA]AA+(Stable) |

*Source: Company*

*Please click here to view details of lender-wise facilities rated by ICRA*

## Annexure II: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| **HPCL-Mittal Pipelines Limited** | 100.0% | Full Consolidation |
| **RJ-ONN-2005/2 E&P block in Rajasthan** | 20.0% | Equity method |

*Source: HMEL*

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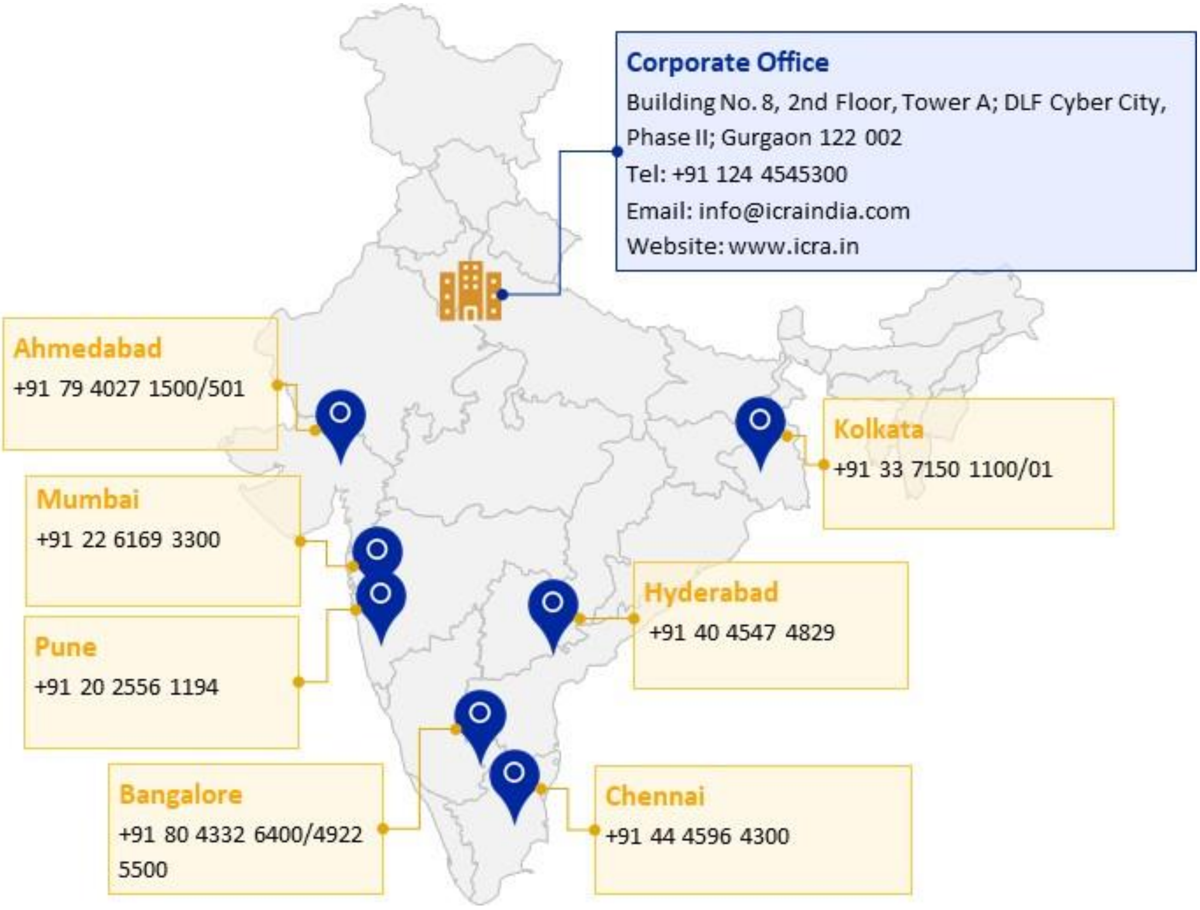




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