January 07, 2021

Hindustan Petroleum Corporation Limited: Ratings reaffirmed at [ICRA]AAA(Stable)/[ICRA]A1+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	17,500.0	17,500.0	[ICRA]AAA (Stable); reaffirmed
Commercial Paper	15,000.0	15,000.0	[ICRA]A1+; reaffirmed
Issuer Rating	-	-	[ICRA]AAA (Stable); reaffirmed
Cash Credit Limits	4,000.0	4,000.0	[ICRA]AAA (Stable); reaffirmed
Fund-based Limits	18,254.0	18,254.0	[ICRA]AAA (Stable); reaffirmed
Non-fund Based Limits	22,746.0	22,746.0	[ICRA]A1+; reaffirmed
Total	**77,500.0**	**77,500.0**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings takes into account the strategic importance of Hindustan Petroleum Corporation Limited (HPCL/ the company) in the domestic energy sector; its strong parentage (Oil and Natural Gas Corporation Limited/ONGC ([ICRA]AAA(stable)/[ICRA]A1+) owns 51.1% equity stake); its established brand name and its leading position in the domestic oil marketing business. The ratings favourably consider the proximity of the company's refineries to the coast, which provides logistical advantage for import of crude oil and export of petroleum products. The ratings also factor in the company's strong operational efficiencies—both its refineries (Mumbai and Vishakhapatnam) have been operating at consistently high utilisation levels. HPCL is undertaking modernisation and capacity expansion at both its refineries to improve the profitability of the refining operations.

The company has witnessed steady growth in its marketing volumes (CAGR of 4.4% over the last five years and 2.4% YoY in FY2020), driven by network expansion of retail outlets, favourable demand environment for motor spirit (MS) and high-speed diesel (HSD), and its established presence in the MS and the HSD segments. The gross refining margins (GRMs) of domestic refiners, including HPCL, witnessed a sharp decline in FY2020 because of weak crack spreads and large inventory losses caused by a sharp fall in crude price in March 2020. In the current fiscal, the overall marketing volume is likely to drop due to weak demand following the Covid-19 pandemic and the consequent lockdown. The GRMs were expected improve over FY2020 levels but remained subdued owing to weak demand globally. However, as the average crude oil price in the current fiscal is expected to remain lower than the preceding fiscal, the fuel and loss component for refineries will be lower, which in turn would support the refining margins. The expected rise in refining margins, along with inventory gains owing to increase in crude oil prices, would also aid GRMs. HPCL's liquidity profile remains strong, backed by an expected healthy cash flow from operations, a sizeable portfolio of liquid investments and an adequate availability of working capital bank limits.

HPCL's operations are subject to regulatory risk pertaining to the pricing of sensitive petroleum products. Nonetheless, over the last few years, the Government of India (GoI) has been ensuring that the net under recoveries borne by the Public Sector Undertaking (PSU) of oil marketing companies (OMCs) are either nil or within manageable levels by absorbing most of the gross under-recoveries (GURs) and sharing the remaining with upstream companies. Any adverse change in the GoI's policy in this regard that weakens the key credit metrics of HPCL will be a key rating sensitivity. The gross under-recoveries (GURs) of public sector oil marketing companies (OMCs) was lower in FY2020 on YoY basis at Rs 245 billion as against Rs 374 billion in FY2019, due to fall in crude oil prices. As per ICRA's estimates, the subsidy requirement for FY2021 is expected to be Rs. 11 billion, assuming the Indian basket of crude price at $45/bbl and an exchange rate of INR/USD 75. Accordingly, the subsidy provided for FY2021 at Rs. 388 billion in the Union Budget of 2020-21 would be adequate to clear the backlog.

HPCL is exposed to project implementation risks as it is implementing large-scale projects spanning the entire downstream value chain as well as through subsidiaries and joint ventures (JVs). Depending on the scale of HPCL's expansion plans, the debt coverage metrics might moderate over the next three-four years; however, ICRA expects them to remain comfortable. Nonetheless, any material time or cost overruns that could lead to larger-than-estimated funding requirements would be a key rating sensitivity. ICRA also notes that the company has moderately rationalised its capex plans for the next three years, considering the impact of the Covid-19 pandemic.

The Stable outlook on the [ICRA]AAA rating reflects ICRA's opinion that HPCL will continue to benefit from its established position in the domestic energy sector, its strategic importance to the GoI, and its strong parentage.

Key rating drivers

Credit strengths

Demonstrated support of GoI to ensure profitability of OMCs despite high under-recoveries - The GoI has provided dedicated support to cushion the OMCs from high under-recoveries in the past by institutionalising a subsidy sharing framework, wherein a large part of the under recoveries is borne by it through budgetary allocation. In FY2020, the gross under-recoveries for HPCL declined to Rs. 281 crore from Rs. 957 crore in FY2019, following a decline in crude price during the period. Despite the change in ownership to ONGC, ICRA believes HPCL will continue to be of strategic importance to the GoI as it will continue to play a key role in fulfilling the socio-economic policies of the GoI. Any adverse change in the GoI's policy in this regard will be a key rating sensitivity.

Coastal refinery provides logistical advantages in terms of sourcing of crude and exports - HPCL owns and operates two refineries, one in Mumbai and the other in Visakhapatnam. Since both the refineries are located in coastal regions, the company enjoys logistical benefits in terms of lower costs and lesser time taken to transport the imported crude to the refineries and to export refined products. This lowers its inventory requirement to a significant extent when compared to other OMCs with inland refineries.

Established brand name and position in domestic marketing business - The company is one of the three leading public OMCs, with a ~24% market share (including private players) as of FY2020. HPCL has the second-largest marketing network spanning across the country and actively undertakes multiple branding and customer loyalty initiatives. Its marketing margins on transportation fuels, industrial fuels and other products have been healthy.

Healthy refining operations - HPCL has reported refinery utilisation levels above 100% for the past few years. The company's GRMs had remained stable in recent years driven by operational efficiencies and effective crude procurement strategies. However, in FY2020, its GRMs declined to US$ 1.03/bbl from US$ 5.01/bbl in FY2019 as crude prices plummeted because of the failure of OPEC+ to agree to production cuts and the Covid-19 pandemic, resulting in huge inventory losses. Further, the GRMs were also impacted by weak crack spreads in light and middle distillates. In H1FY2021, the company reported a GRM of US$ 2.58/bbl on the back of healthy inventory gains of around ~Rs. 2400 crore owing to an increase in crude oil prices. Nonetheless, the GRMs are expected to witness improvement in FY2021 due to expected recovery in crude prices and lower fuel and loss, although they are likely to remain subdued because of weak demand and supply overhang globally. The marketing margins also witnessed a strong growth because of lower crude prices even as retail prices were not reduced; however, after excise duty hikes by the GoI in May 2020, the marketing margin has moderated to a more normalised level. Going forward, with the completion of expansion projects, the scale and cash flows are expected to witness improvement in the medium term.

Healthy financial flexibility - The company enjoys high financial flexibility that allows it to raise debt and access capital markets at competitive rates to fund its capex and working capital requirements. The flexibility is supported by HPCL's strong parentage arising from ONGC's 51.1% stake.

Credit challenges

Vulnerability of refining segment's profitability to global refining margin cycle, crude price volatility, import duty protection, and INR-US$ parity levels - Given the nature of the business, the company would remain exposed to the movement in the commodity price cycles and the volatility in the crude prices. Any adverse changes in the import duty on its products would also have an impact on the company's profitability on domestic sales. HPCL's profitability is also exposed to the forex rates (INR-US$), given the business is primarily dollarised on sales, crude procurement and forex loans.

Moderate financial profile – HPCL's key credit metrics, such as Total Debt/OPBDITA, interest coverage and RoCE[1], were moderate for a long period till FY2020 when they deteriorated owing to weak profitability. The profitability and credit metrics are expected to improve in FY2021, however, with large capital outlay on the ongoing projects, its metrics would not see any meaningful improvement till the investments start yielding returns.

Significant capex planned over next three-year period - The company is undertaking an aggressive capex plans worth ~ Rs. 39,000 crore (including equity investments of ~Rs. 7,200 crore in JVs) from FY2021 to FY2023. However, the Covid-19 pandemic has compelled the company to moderately rationalise its capex plan. HPCL's capex plans include the implementation of major projects such as the capacity expansion at both its refineries, expansion of its pipeline network and setting up of new pipelines. The company would also have significant equity contribution towards key JV projects, including the refinery-cum-petrochemical complex in Rajasthan (74% stake) and the LNG terminal in Gujarat (50% stake). While the Rajasthan refinery is expected to be commissioned by December 2023, the expansion of the Mumbai refinery is expected to be completed by Q1FY2022 and the Visakh refinery by Q3FY2022. Any material time or cost overruns in the group projects could increase the company's borrowing levels and weaken the credit metrics.

Lack of freedom in pricing of sensitive petroleum products - While MS and HSD are deregulated, at times the PSU OMCs face pressure in revising the prices in line with the global prices. Moreover, the price of LPG (domestic) is

[1] Return on capital employed

controlled, on which the GoI pays subsidy to cover the under recoveries. Though the GoI has been ensuring that net under-recoveries of OMCs are either nil or within manageable levels, any increase in the same in a scenario of high crude oil prices would impact the key credit metrics of the company. In March 2020, the GOI instructed state-run oil companies to price PDS[2] SKO[3] at market rates, following the moderation in crude prices, thereby eliminating the subsidy. However, any change in the GoI's policy, with hardening of crude prices, remains a sensitivity factor.

Liquidity position: Strong

HPCL's liquidity is expected to remain strong, aided by healthy cash flow generation and sizeable cash and cash equivalents (Rs. 5,458 crore on standalone books as on March 31, 2020). Further, the company has adequate fund-based and non-fund based working capital limits, a sizeable part of which is unutilised. It also enjoys high financial flexibility owing to its strong parentage.

Rating sensitivities

Positive triggers – Not Applicable

Negative triggers – Downward pressure on HPCL's ratings could arise if a) a significant increase in net under-recoveries, due to changes in Government policies on pricing/subsidy sharing on sensitive petroleum products, erodes the company's profits and cash flows b) Reduction in ONGC's shareholding below 50%

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Downstream Oil Companies
Parent/Group Support	Parent: Oil and Natural Gas Corporation Limited The assigned rating factors in the systemic importance that HPCL holds, which we expect should induce the Government/ONGC to extend timely policy/financial support to the rated entity, should there be a need
Consolidation / Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of HPCL. ICRA has factored in the rated entity's support to fund the equity component of the investment in its JV projects, any cost overruns, and debt servicing support in the initial stage of operations. The subsidiaries and JVs of HPCL that have been considered are enlisted in Annexure 2.

About the company:

HPCL is a public-sector enterprise that owns and operates two refineries, one in Mumbai with 7.5 million metric tonnes per annum (MMTPA) capacity and one in Visakhapatnam with an 8.3 MMTPA capacity. The company was incorporated in 1952 as Standard Vacuum Refining Company of India Limited. HPCL has a 49% stake in a JV with Mittal Energy Investments Pte Limited for operating an 11.3 MMTPA refinery in Bhatinda, Punjab. HPCL has a 16.95% equity stake in Mangalore Refinery and Petrochemicals Ltd. (MRPL), which operates a 15 MMTPA refinery

[2] Public distribution system

[3] Superior kerosene oil

in Mangalore. Majority shareholding of HPCL (51.1%) is held by ONGC, which was acquired from the GoI in January 2018. In October 2019, the company was granted 'Maharatna' status, which implies higher operational and financial autonomy.

Key financial indicators (Consolidated - audited)

	FY2019	FY2020	H1 FY2021*
Operating Income (Rs. crore)	275,473	269,092	89,614
PAT (Rs. crore)	6,691	2,639	5,228
OPBDIT/OI (%)	4.4%	2.1%	8.9%
PAT/OI (%)	2.4%	0.98%	5.8%
Total Outside Liabilities/TNW (times)	2.5	2.8	2.5
Total Debt/OPBDIT (times)	2.3	7.0	3.8
Interest Coverage (times)	15.5	5.0	13.1

*Source: HPCL *Unaudited*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2021)					Chronology of Rating History for the Past 3 Years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Rating		FY2020		FY2019	FY2018		
					07-Jan-21	23-July-20	10-Jan-20	1-Oct-19	8-Jan-19	29-Mar-18	24-Jan-2018	4-Dec-17
1	NCDs	Long Term	10,000	3,200^	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-	-	-	-	-
2	NCDs	Long Term	7,500	7,500	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
3	Commercial Paper	Short term	15,000	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
4	Cash Credit	Long term	4,000	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
5	Fund Based Limits	Long term	18,254	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
6	Non-Fund Based Limits	Short term	22,746	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
7	Issuer Rating	-	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)

^company has placed only Rs. 3,200 Crore till date

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	NCDs	Yet to be placed	-	-	6,800.0	[ICRA]AAA (Stable)
INE094A08077	NCDs	October 2020	4.79%	October 2023	2,000.0	[ICRA]AAA (Stable)
INE094A08077	NCDs	August 2020	5.36%	April 2025	1,200.0	[ICRA]AAA (Stable)
INE094A08069	NCDs	March 2020	7.03%	April 2030	1,400.0	[ICRA]AAA (Stable)
INE094A08051	NCDs	January 2020	6.38%	April 2023	600.0	[ICRA]AAA (Stable)
INE094A08044	NCDs	October 2019	6.8%	December 2022	3,000.0	[ICRA]AAA (Stable)
INE094A08036	NCDs	August 2019	7.0%	August 2024	2,000.0	[ICRA]AAA (Stable)
INE094A08028	NCDs	April 2019	8.0%	April 2024	500.0	[ICRA]AAA (Stable)
NA	Commercial Paper	-	-	7-365 days	15,000.0	[ICRA]A1+
NA	Cash Credit Limits	-	-	-	4,000.0	[ICRA]AAA (Stable)
NA	Fund Based Limits	-	-	-	18,254.0	[ICRA]AAA (Stable)
NA	Non-Fund Based Limits	-	-	-	22,746.0	[ICRA]A1+
NA	Issuer Rating	-	-	-	-	[ICRA]AAA (Stable)

Source: Hindustan Petroleum Corporation Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Prize Petroleum Co. Ltd.	100.00%	Full Consolidation
HPCL Biofuels Ltd.	100.00%	Full Consolidation
HPCL Middle East FZCO	100.00%	Full Consolidation
HPCL Rajasthan Refinery Limited	74.00%	Limited Consolidation
HPCL Shapoorji Energy Private Ltd.	50.00%	Limited Consolidation
Ratnagiri Refinery and Petrochemicals Limited	25.00%	Limited Consolidation
HPCL Mittal Energy Ltd.	48.99%	Limited Consolidation
Bhagyanagar Gas Ltd.	48.73%	Limited Consolidation
Aavantika Gas Ltd.	49.99%	Limited Consolidation
IHB Pvt. Ltd.	25.00%	Limited Consolidation

Petronet MHB Ltd.	50.00%	Limited Consolidation
Godavari Gas Ltd.	26.00%	Limited Consolidation
Hindustan Colas Pvt. Ltd.	50.00%	Limited Consolidation
South Asia LPG Co. Pvt. Ltd.	50.00%	Limited Consolidation
Mumbai Aviation Fuel Farm Facility Pvt. Ltd.	25.00%	Limited Consolidation
HPOIL Gas Pvt. Ltd.	50.00%	Limited Consolidation
Mangalore Refinery and Petrochemicals Limited	16.96%	Limited Consolidation
GSPL India Gasnet Limited	11.00%	Limited Consolidation
GSPL India Transco Limited	11.00%	Limited Consolidation

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About ICRA Limited:

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