July 29, 2022

HPCL-Mittal Energy Limited: Rating reaffirmed; reaffirmed and withdrawn for Rs. 1587-crore NCD programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Term loan	13,441.0	13,441.0	[ICRA]AA+ (Stable); reaffirmed
NCD 1	1,000.0	1,000.0	[ICRA]AA+ (Stable); reaffirmed
NCD 2	1,000.0	1,000.0	[ICRA]AA+ (Stable); reaffirmed
NCD 3	45.0	45.0	[ICRA]AA+ (Stable); reaffirmed
NCD 4	87.0	0.0	[ICRA]AA+ (Stable); reaffirmed and withdrawn
NCD 5	1,500.0	0.0	[ICRA]AA+ (Stable); reaffirmed and withdrawn
Total	**17,073.0**	**15,486.0**	

**Instrument details are provided in Annexure-I*

Rationale

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

The rating reaffirmation factors in HMEL's strategic importance and operational linkages with the parent Hindustan Petroleum Corporation Limited (HPCL, [ICRA]AAA(Stable)/[ICRA]A1+), the high complexity of its refinery which aids its gross refining margins (GRMs) and the financial flexibility, owing to which the company has refinanced most of the long-term debts resulting in low debt repayments in the near to medium term and elongated maturity profile. As a result of this refinancing, the break-even GRM for HMEL to service its debt obligations and meet operational expenses will remain lower than the actual GRMs posted. Moreover, HMEL's refinery is also 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. Over the last few quarters, the GRMs have remained strong, resulting in healthy EBITDA generation for the company. While the GRMs have started to moderate now, the profit generation for the current fiscal is likely to remain healthy, with generation in the next fiscals being supported by commencement of the petrochemical capacities.

Furthermore, HMEL is strategically important for HPCL to meet the demand in the northern region, since 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, resulting in mitigation of the offtake risk. Additionally, HPCL has provided operational and financial support to HMEL in the past and also additional support in the form of letters of comfort backing part of the borrowing programme as well as the Sponsor Support Agreement (SSA) for funding any cost over-runs in the petrochemical capex being undertaken by HMEL.

However, the ratings are tempered by the residual project implementation risks related to the large petrochemical project (1.2 MMTPA mixed feed cracker) being set up at original estimated capital outlay of ~Rs. 20,162 crore (net of Cenvat credit), which has witnessed some cost overrun, which is keeping the debt at elevated levels. The project witnessed cost and time overruns, however, the same is likely to commence commercial production soon. The company is also exposed to residual project implementation risks as petrochemical plants tend to be highly complex in nature and can take significant time for stabilisation and production ramp up.

ICRA takes comfort from the involvement of reputed EPC firms in the project, execution of key units on LSTK basis, as well as the experience of the company in executing large projects which are expected to mitigate the project implementation risks to some extent. 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 as inventory losses/gains are likely to be higher for land-locked refineries like HMEL in a scenario of sharp fall/rise in crude oil prices because of high inventory holdings.

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

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

ICRA has withdrawn the rating on Rs. 87 crore NCD as the same has been paid in full. Moreover, the Rs. 1500-crore NCD has been withdrawn on the request of the company as the same was not placed by the company.

Key rating drivers and their description

Credit strengths

Long and established track record of HPCL in the domestic refining and marketing business: The ratings of HMEL consider the support from HPCL, with it being the lead sponsor with a long track record in the refining segment and its ability to provide financial flexibility. HPCL 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. The strong credit profile of its main sponsors is a definite positive.

Favourable location of refinery in petroleum products deficit and high growth northern region: HMEL's refinery is situated in the petroleum products-deficit northern region of the country, where the 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 at Bathinda of HMEL. The demand in this region surpasses the combined capacity of these refineries. Hence, the products are transported from the western part of the country to cater to the local demand. Post commissioning of HMEL's refinery, the shortage has decreased in the northern region.

Superior refining capability and high operational efficiency and healthy capacity utilisation over the last couple of years: HMEL's refinery has the capability to process mostly heavy and sour crude oils (average APIº: 26) and achieve high distillate yield. As the demand of middle distillates is expected to increase in the domestic market, the configuration has been selected to maximise the yield of the same. 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 healthy capacity utilisation levels (>100%) barring FY2021 when the throughput was impacted initially by Covid-19 lockdown and a 37 -day refinery turnaround in Q4 FY2021. The capacity utilisation in FY2022 witnessed significant uptick with a 13.0 MMTPA throughput indicating capacity utilisation of 115% and the same remained high for Q1 FY2023 as well.

Healthy financial flexibility: The ratings factor in the heathy financial flexibility of HMEL reflected in refinancing its term loan obligations. The term debt repayments will remain low for FY2023, with gradual increase in the same going forward.

Credit challenges

Large debt-funded capex for petrochemical project coupled with weak refining margin cycle leading to delay in deleveraging: HMEL is executing a petrochemical project to diversify its product slate, which should reduce the exposure to 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, being set up at original estimated capital outlay of ~Rs. 20,162 crore (net of Cenvat credit), which has witnessed some cost overrun. As a major portion of the project funding is being met through debt, it would delay the deleveraging of the balance sheet of HMEL. However, the debt tied-up for the petrochemical project has a long moratorium and repayment tenure, which provides comfort from a credit perspective. Further, given the healthy refining margins, it is likely that the entire debt will not be availed for this capex.

Residual project implementation risks related to petrochemical project; SSA signed with lenders provides comfort in case of cost overruns: The petrochemical projects are complex with material challenges in implementation, stabilisation and ramp up phases. The project has already witnessed time and cost overruns. However, ICRA takes comfort from the involvement of reputed EPC firms in the project, execution of key units on LSTK basis as well as the experience of the company in executing large projects, which are expected to mitigate the project-implementation risks to some extent and prevent any time overrun. The Sponsor Support Agreement (SSA) signed by the promoters with the lenders to meet any cost over-runs and or equity shortfall related to the petrochemical project through equity infusion and maintenance of the targeted debt:equity ratio of the project provides comfort as it will ensure the overall credit metrics remain stable for the company.

Vulnerability of profitability to the volatility in crude oil and petroleum product prices, 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 the GRMs globally. Being a deregulated sector, HMEL's profits are exposed to the international refining cycle. Besides, crude oil and most of petroleum products are priced in US$/bbl or US$/MT, which along with significant foreign currency debt, leads to vulnerability of the profits 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 in this regard will negatively impact the profits. HMEL's refinery at Bathinda is landlocked, which makes it relatively more vulnerable to crude oil price volatility as inventory losses/gains are likely to be higher for such refineries in a scenario of sharp fall/rise in crude oil prices because of 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 the same. 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' given the large capex and equity funding for the project will consume most of the company's cash accruals.

Rating sensitivities

Positive factors – A rating upgrade will be contingent on successful commissioning and stabilisation of the petrochemicals project. Material improvement in the cash generation resulting in deleveraging of the balance sheet would be a positive trigger.

Negative factors – Weakening of the credit risk profile of HPCL, weakening of linkages of HMEL with HPCL, and any significant deterioration in HMEL's standalone financial risk profile could lead to a downward revision in ratings.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Downstream Oil Companies Impact of Parent or Group Support on an Issuer's Credit Rating Policy on Withdrawal of Credit Ratings
Parent/Group support	**Parent: Hindustan Petroleum Corporation Limited** The ratings take in to account the parentage of HPCL as the parent has provided significant equity support in the past, strategic importance of HMEL to the parent given the take-or-pay offtake agreement for liquid products and absence of HPCL refinery capacity in petroleum

	product-deficit northern India. HPCL has also provided a Letter of Comfort for some of the term loans of HMEL and SSA for the petrochemical project.
Consolidation/Standalone	The ratings are based on consolidated financials of HMEL along with its wholly-owned subsidiary HPCL-Mittal Pipelines Limited in view of significant synergies in their businesses. The consolidation also includes a 20% participatory stake in an E&P block RJONN-2005/2 in Rajasthan.

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 a stake of 48.99% in the company each 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 commissioned a greenfield refinery complex with 9 MMTPA capacity at Bathinda (Punjab) along with captive power plant of 165 MW. The refinery is configured to process a wide range of crudes and produce BS VI auto fuels. In June 2017, HMEL completed expansion of its refining capacity from 9 MMTPA to 11.3 MMTPA. The company is also in the midst of setting up a 1.2 MMTPA petrochemical plant 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 a single-point mooring (SPM) facility at the Mundra Port, Gujarat and a cross-country pipeline for transportation of crude oil from Mundra to Bathinda.

Key financial indicators (audited)

HMEL Consolidated	FY2021	FY2022
Operating Income (Rs. crore)	26,554.1	59,105.2
PAT (Rs. crore)	403.6	1,257.6
OPBDIT/OI (%)	8.9%	10.9%
PAT/OI (%)	1.5%	2.1%
Total Outside Liabilities/Tangible net worth (times)	3.9	4.6
Total Debt/OPBDIT (times)	13.8	5.3
Interest coverage (times)	2.6	6.5

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore
Note: Amount in Rs. crore; All calculations are as per ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)				Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021		Date & rating in FY2020
					Jul 29, 2022	Jul 30, 2021	Mar 23, 2021	Aug 24, 2020	Jan 30, 2020
1	Term loans	Long term	13,441.00	8,404.0	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
2	Long term-Non-convertible Debentures	Long term	2045.0	2045.0	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3	Long term-Non-convertible Debentures	Long term	1587.0	-	[ICRA]AA+ (Stable); withdrawn	[ICRA]AA+ (Stable)	-	-	-
4	Commercial Paper Programme	Short term	-	-	-	-	[ICRA]A1+; withdrawn	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term fund-based – Term Loan	Simple
Long-term – NCD	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: www.icra.in

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	13,441.0	[ICRA]AA+(Stable)
INE137K07034	**Bond Programme**	September 3, 2012	10.9%	September 3, 2022	45.00	[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)
INE137K07026	**Bond Programme**	September 3, 2012	10.9%	September 3, 2021	87.0	[ICRA]AA+(Stable); withdrawn
Unplaced	**Bond Programme**	-	-	-	1500.0	[ICRA]AA+(Stable); withdrawn

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	HMEL 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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