

July 28, 2023

HPCL-Mittal Energy Limited: Ratings reaffirmed; reaffirmed and withdrawn for Rs. 45.0-crore NCD programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based – Term loan	13,441.0	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NCD 3	45.0	0.0	[ICRA]AA+ (Stable); reaffirmed & withdrawn
Total	15,486.0	15,441.0	

*Instrument details are provided in Annexure-I

Rationale

To arrive at the ratings 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 operational linkages with parent Hindustan Petroleum Corporation Limited (HPCL, [ICRA]AAA(Stable)/[ICRA]A1+), along with 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. As a result of this refinancing/prepayments, the break-even GRM for HMEL to service its debt obligations and meet the operational expenses will remain 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.

In the last fiscal, the GRMs remained strong, resulting in healthy EBITDA generation for the company. While the GRMs have started to moderate now with a lackluster global demand scenario, the petrochemical unit is likely to support profit generation in the current fiscal.

Further, HMEL is strategically important for HPCL to meet the demand for petroleum products in the 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, mitigating the offtake risk. Additionally, HPCL has provided operational and financial support to HMEL in the past. It has extended support in the form of letters of comfort to back a part of the borrowing programme and also has a sponsor support agreement (SSA) to fund any cost overruns in the petrochemical capex undertaken by HMEL.

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). While the project has been commissioned, the stabilisation and ramp-up of production remains a key monitorable. 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 as 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 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.

ICRA has withdrawn the rating on Rs. 45 crore NCD as the same has been paid in full.

Key rating drivers and their description

Credit strengths

Long and established track record of HPCL in domestic refining and marketing business – The ratings of HMEL consider 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 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 at 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 to cater to the local demand. 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 API[®]: 26) and achieve 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%), barring FY2021 when the throughput was impacted by the Covid-19 lockdown and the 37-day refinery turnaround in Q4 FY2021. The throughput was 12.7 MMTPA in FY2023, indicating capacity utilisation of 113%, and remained high for Q1 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 ratings factor in the healthy financial flexibility of HMEL, reflected in its ability to refinance its term loan obligations. The term debt repayments will remain low for FY2024, with a gradual increase, going forward.

Credit challenges

Large debt-funded capex for petrochemical project; debt levels elevated due to cost and time overruns in project – HMEL has recently commissioned a petrochemical project 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, being set up at an original estimated capital outlay of ~Rs. 20,162 crore (net of Cenvat credit). The cost overrun shot up the final proposed cost to ~Rs. 25,082 (net of Cenvat credit). As a near to equal portion of the project funding is being met through debt, it would delay the deleveraging of HMEL's balance sheet. However, 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 in this regard 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 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 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 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 ratings can be upgraded if a ramp-up of the petrochemical capacity and steady refining margins lead to healthy cash flow generation, resulting in a material deleveraging of the balance sheet.

Negative factors – The ratings may be downgraded if the credit risk profile of HPCL weakens, or HMEL's linkages with HPCL weaken, or if there is any significant deterioration in HMEL's standalone financial risk profile.

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. 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. 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 the consolidated financials of HMEL along with its wholly-owned subsidiary - HPCL-Mittal Pipelines Limited - in view of the 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 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 Bhatinda 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	59105.2	78,040.4
PAT	1257.6	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 of Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	
					Jul 28, 2023	Jul 29, 2022	Jul 30, 2021	Mar 23, 2021	Aug 24, 2020
1	Term loans	Long term	13,441.0	7,920.2	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
2	Long term - Non-convertible debentures	Long term	2000.0	--	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)
3	Long term - Non-convertible debentures	Long term	45.0	--	[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

Instrument	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	13,441.0	[ICRA]AA+(Stable)
INE137K07034	Bond programme	September 3, 2012	10.9%	September 3, 2022	45.0	[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	LTHL 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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