August 24, 2020

HPCL-Mittal Energy Limited (HMEL): Rating of [ICRA]AA+(Stable) assigned to fresh bond programme; Ratings reaffirmed for existing borrowing programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans	13,441.00	13,441.00	[ICRA]AA+ (Stable); reaffirmed
Long Term Bond Programme	1221.80	1221.80	[ICRA]AA+ (Stable); reaffirmed
Long Term Bond Programme	0.00	1000.00	[ICRA]AA+ (Stable); Assigned
Commercial Paper	1500.00	1500.00	[ICRA]A1+; reaffirmed
Total	**16,162.8**	**17,162.8**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation factors in the 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 high financial flexibility owing to which the company has refinanced most of the long term debt resulting in low debt repayments in the near to medium term. Since HPCL does not have any refinery in the high growth northern region, HMEL is strategically important for HPCL to meet the demand in the northern region. HMEL contributes nearly 21% to the total sales and nearly 73% to the North India sales of HPCL. HMEL has a product offtake agreement with HPCL with take-or-pay clause for its liquid products till the year CY2026 resulting in mitigation of offtake risk. Nevertheless, since the offtake of products is based on international prices, the risk related to the GRMs continues to be there for HMEL. Additionally, HPCL has provided operational and financial support to HMEL in the past and has provided support in the form of letters of comfort backing part of the borrowing programme as well as "Sponsor Support Agreement" (SSA) for funding any cost over runs in the petrochemical capex being undertaken by HMEL. The latter's refinery is also one of the most complex refineries in India with a Nelson complexity Index (NCI) of 12.6. Owing to the high complexity of its refinery, HMEL is able to process heavier grades of crude oil resulting in higher GRMs vis-a-vis low complexity refineries. The distillate yield of HMEL is high at around 85% with 50% of the product slate comprising of diesel. The ratings also factor in the high financial flexibility of HMEL; expected refinancing of the term debt by the company will keep the debt repayments low and conserve cash to fund the equity portion of the petrochemical capex despite moderation in the GRMs in CY2020.

However, the ratings are constrained by the subdued refining margins and residual project implementation risks related to the large petrochemical project (1.2 MMTPA mixed feed cracker) being set up at a capital outlay of ~Rs. 23,200 crore (including a Cenvat credit Rs. 2600 crore), which would also delay deleveraging of the balance sheet. ICRA notes that the commissioning date for the petrochemical plant has been revised to September 2021 due to the slowdown in project execution post the Covid-19 related restrictions. ICRA takes comfort from the involvement of reputed EPC firms in the project, execution of key units on EPCM (LSTK) basis, higher-than-scheduled project progress as well as the experience of the company in executing large projects which are expected to mitigate the project implementation risks to some extent. Nevertheless, any material time or cost overruns for the petrochemical project could adversely impact its viability and the overall credit profile of HMEL and thus would be a key rating sensitivity. Nonetheless, SSA signed with lenders would partly mitigate the above risk. The ratings are also constrained by 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 landlocked refineries like HMEL in a scenario of sharp fall/rise in crude oil prices because of high inventory holdings.

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 metrics are expected to moderate in the near to medium term driven by the large petrochemical capex and weak refining cycle, the same are expected to improve once the petrochemical project starts generating cash. Additionally, the commissioning of the petrochemical plant will diversify revenues and profits and lower the exposure to the refining cycle.

Key rating drivers and their description

Credit strengths

Long and established track record of HPCL , one of its two major promoters, in the domestic refining and marketing business with product offtake agreement on a take or pay basis with HMEL: The ratings of HMEL consider the support from HPCL, with it being lead sponsor with long track record in the refining segment and providing 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. HMEL contributed ~21% to HPCL's sales of petroleum products in FY2019. The strong credit profile of its main sponsors has also provided high financial flexibility for the company.

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. However, the demand-supply gap continues to be huge owing to the robust growth in the demand of petroleum products, which stood at 56.6 MMT in FY2020 against a regional supply of around 34.3 MMTPA. With no major capacity additions in the medium term, there would be continued supply deficit for the major petroleum products.

Superior refining capability and high operational efficiency characterised by high Nelson complexity index (NCI) 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 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%). The capacity utilisation is expected to be impacted in FY2021 by the initial loss of production to match the demand for products in the immediate aftermath of the Covid-19 lockdown.

High financial flexibility indicated by refinancing of the long-term loans in the past resulting in low debt repayments: the ratings also factor in the high financial flexibility of HMEL in refinancing its term loan obligations resulting in low debt repayments. ICRA expects HMEL to refinance the upcoming debt repayments in FY2022 and FY2023 as well to keep the debt repayment obligations lower till the petrochemical capex is completed.

Credit challenges

Large debt-funded capital expenditure 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 involves setting up of a 1.2 MMTPA (of ethylene) multi-feed cracker with fuel gas, naphtha and other petroleum outputs of the refinery as feedstocks. The estimated capital outlay for the project is ~Rs. 22,758 crore (net of CENVAT credit of Rs. 2,600 crore), which is planned to be funded with debt of ~Rs. 13,441 crore and balance through internal accruals and input tax credit. As a major portion of project funding will be met through debt, it would delay the deleveraging of the balance sheet of HMEL, as envisaged earlier. However, the debt tied-up for the petrochemical project has a long moratorium and repayment tenure, which provides comfort from a credit perspective.

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. Further, due to the large gestation period, efficient implementation remains the key to complete the project in a timely manner without cost overruns. However, ICRA takes comfort from the involvement of reputed EPC firms such as Technimont in the project, execution of key units on LSTK basis, higher-than-scheduled project progress 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. Nevertheless, material time or cost overruns for the petrochemical project could adversely impact its viability and overall credit profile of HMEL and thus would be a key rating sensitivity. The Sponsor Support Agreement (SSA) signed by promoters with the lenders to meet any cost over runs and or equity shortfall related to the petrochemical project through equity infusion and maintaining 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; sensitivity to volatility in crude oil prices higher due to land locked refinery: 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. Given the current low refining margins resulting in lower cash accruals, the liquidity position of the company is expected to remain adequate to meet the sizeable equity funding requirements of the project and debt repayments in the near to medium term.

Rating sensitivities

Positive triggers – A rating upgrade looks unlikely in the near to medium term given the delay in deleveraging resulting from the debt availed for the petrochemical project and weak refining margin cycle. Material improvement in the cash generation from refining operations and/or petrochemical project resulting in deleveraging of the balance sheet would be a positive trigger.

Negative triggers – a) Any change in shareholding of HPCL resulting in weaker credit profile or weakening of the credit risk profile of HPCL, b) Weakening of linkages of HMEL with HPCL, and c) Any significant deterioration in HMEL's standalone financial risk profile could lead to downward revision in ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Downstream Oil Companies
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 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 (including RJ-ONN-2005/2 E&P block in Rajasthan) 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 green field 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 1.2MMTPA petrochemical plant 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 for transportation of crude oil from Mundra to Bathinda.

Key financial indicators (audited- HMEL consolidated)

	FY2019	FY2020
Operating Income (Rs. crore)	47,830.6	42,798.2
PAT (Rs. crore)	1,468.3	-65.6
OPBDIT/OI (%)	10.6%	7.3%
RoCE (%)	12.4%	3.9%
Total Outside Liabilities/Tangible Net Worth (times)	2.9	3.7
Total Debt/OPBDIT (times)	4.6	9.4
Interest Coverage (times)	3.8	2.4
DSCR	2.3	1.6

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg. (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital; DSCR= (Net Profit After Tax + Gross Interest + Depreciation) / (Gross Interest + Repayment + Dividend on preference Shares)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019		FY2018	
					August 24, 2020	January 30, 2020	31-Dec-18	26-Dec-18	15-Feb-18	28-Sep-17
1	NCD	Long term	1221.80	1221.80	[ICRA]AA+(Stable)	[ICRA]AA+(Stable)	[ICRA]AA+(Stable)	[ICRA]AA+(Stable)	[ICRA]AA(Positive)	[ICRA]AA(Positive)
2	NCD	Long term	1000.00	-	[ICRA]AA+(Stable)	-	-	-	-	-
3	Term Loan	Long Term	13441.00	6246.80*	[ICRA]AA+(Stable)	[ICRA]AA+(Stable)	[ICRA]AA+(Stable)	-	-	-
4	Commercial paper	Short Term	1500.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-

*Amount in Rs. crore ; *As on March 31, 2020*

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
-	Term loan-1	September 26, 2018	-	June, 2032	2,250.00	[ICRA]AA+ (Stable)
-	Term loan-2	5 July 2019	-	June, 2032	890.00	[ICRA]AA+ (Stable)
-	Term loan-3	March 31, 2020	-	September, 2030	304.00	[ICRA]AA+ (Stable)
-	Term loan-4	May 26, 2017	-	June, 2032	9,997.00	[ICRA]AA+ (Stable)
INE137K07018	Bond Programme	September 3, 2012	-	September 3, 2020	90.00	[ICRA]AA+ (Stable)
INE137K07026	Bond Programme	September 3, 2012	-	September 3, 2021	86.90	[ICRA]AA+ (Stable)
INE137K07034	Bond Programme	September 3, 2012	-	September 3, 2022	44.90	[ICRA]AA+ (Stable)
INE137K07042	Bond Programme	February 28, 2020	-	February 28, 2030	1000.0	[ICRA]AA+ (Stable)
-	Bond Programme#	-	-	-	1000.0	[ICRA]AA+ (Stable)
NA	Commercial Paper	NA	NA	7-365 days	1,500.00	[ICRA]A1+

Source: HMEL; # Yet to be placed

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
HPCL-Mittal Pipelines Limited	100.00%	Full Consolidation
RJ-ONN-2005/2 E&P block in Rajasthan	20.0%	Equity Method

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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