January 10, 2020

Hindustan Petroleum Corporation Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture Programme	7,500	7,500	[ICRA]AAA (Stable); reaffirmed
Commercial Paper	15,000	15,000	[ICRA]A1+; reaffirmed
Issuer Rating	-	-	[ICRA]AAA (Stable); reaffirmed
Cash Credit Limits	4,000	4,000	[ICRA]AAA (Stable); reaffirmed
Fund based Limits	18,254	18,254	[ICRA]AAA (Stable); reaffirmed
Non-fund Based Limits	22,746	22,746	[ICRA]A1+; reaffirmed
Total	**67,500**	**67,500**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings take into account HPCL's strategic importance in the domestic energy sector, its strong parentage with Oil and Natural Gas Corporation Limited ([ICRA]A1+) owning 51.1% equity stake, its established brand name and leading position in the domestic oil marketing business. The ratings favourably consider the coastal location of the company's refineries, which provides logistical advantages for import of crude oil and export of petroleum products. The ratings factor in its strong operational efficiencies with both the refineries (Mumbai and Vishakhapatnam) operating at consistently high utilisation levels with healthy energy consumption levels. HPCL is undertaking modernisation and capacity expansion at both its refineries and the same is expected to improve the profitability from the refining operations upon completion. The gross refining margins (GRMs) for domestic refiners, including HPCL, witnessed a decline in FY2019 and H1 FY2020 due to weakness in crack spreads of light and middle distillates. However, GRM levels are likely to improve from Q4 FY2020 owing to an increase in crack spreads for diesel with the upcoming implementation of the International Maritime Organisation (IMO) norms w.e.f. January 2020. The company has witnessed steady growth in its marketing volumes (CAGR of 4.6% over the last five-year period and 3.3% YoY in H1 FY2020) driven by its growing network of retail outlets, favourable demand environment for motor spirit and diesel, and its established presence in this business segment. HPCL's liquidity profile is strong backed by anticipated healthy cash flow from operations, a sizeable portfolio of liquid investments and adequate availability of working capital bank limits.

HPCL's operations are subject to regulatory risk on the pricing of sensitive petroleum products. Nonetheless, over the last few years, the GoI has been ensuring that the net under recoveries borne by the Public Sector Undertaking (PSU) oil marketing companies (OMCs) are either nil or within manageable levels by absorbing most of the gross under-recoveries (GURs) itself with the rest shared by upstream companies. Any adverse change in the GoI's policy in this regard, resulting in a weakening of key credit metrics of HPCL, will be a key rating sensitivity. There were large opening arrears of Rs. 330 billion on account of under recoveries on the sale of sensitive products, which the GoI had not paid the OMCs in FY2019 on account of under provisioning of subsidy. As per ICRA's estimates, subsidy requirement for FY2020 will be Rs. 265 billion, assuming Indian basket crude price of $65/bbl and INR/USD of 71. While the subsidy provided for FY2020 is adequate, the backlog will continue to remain necessitating high working capital borrowings for the PSU OMCs, as has been witnessed in FY2019.

HPCL is exposed to project implementation risks as it is in the midst of implementing large-scale projects spanning the entire downstream value chain on its own books as well as through subsidiaries and joint ventures (JVs). The scale of HPCL's expansion plans would lead to some moderation in its debt coverage metrics over the next three-four years, but ICRA expects the same 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.

The Stable outlook on the [ICRA]AAA rating reflects ICRA's opinion that HPCL will continue to benefit from its 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 in past 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 large part of the under recoveries are borne by it through budgetary allocation. In H1 FY2020, the gross under-recoveries for HPCL declined to Rs. 209 crore from Rs. 544 crore in H1 FY2019 following a decline in crude prices during the period. Despite 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 socio-economic policies of the GoI. Any adverse change in the GoI's policy in this regard will be a key rating sensitivity.

Logistical advantages being a coastal refinery for sourcing of crude as well as 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 the 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 ~22% market share (including private players) as of end of FY2019. HPCL has the second-largest marketing network spanning across the country and actively undertakes multiple branding and customer loyalty initiatives. Moreover, its marketing margins on transportation fuels, industrial fuels and other products have been healthy.

Healthy refining operations with steady GRM levels - HPCL has reported refinery utilisation levels above 100% for the past few years. The company's GRMs remained stable driven by operational efficiencies and effective crude procurement strategies. However, in FY2019, its GRMs declined to US$ 5.01/bbl from US$ 7.40/bbl in FY2018. The weakness in GRM levels continued in H1 FY2020 with the GRM declining to US$ 1.87/bbl from US$ 5.93/bbl in H1 FY2019, owing to higher crude prices and adverse movement in light and middle distillate cracks. However, GRMs are likely to improve from Q4 FY2020 owing to an anticipated improvement in crack spreads of diesel following the implementation of the new IMO norms in January 2020.

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 same is supported by HPCL's strong parentage arising from ONGC's 51.1% stake.

Credit challenges

Vulnerability of the company's refining segment's profitability to the 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 dollarized on sales, crude procurement and forex loans.

Moderate financial profile - Although HPCL has demonstrated healthy credit metrics in FY2019, its key credit metrics, such as Total Debt/OPBDITA, interest coverage and RoCE[1], over a longer period have been moderate. Moreover, with large capital outlay on the ongoing projects, its metrics would not see any meaningful improvement over the next three-four years till the investments start yielding returns.

Significant capex planned over next four-year period - The company is in the midst of aggressive capex plans of ~ Rs. 66,000 crore (including equity investments of ~Rs. 9,500 crore in JVs) outlined for the period between FY2020 and FY2024. 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. It would also have significant equity contribution towards key JV projects including the refinery-cum-petrochemical complex in Rajasthan (74% stake) and the setting up of its LNG terminal in Gujarat (50% stake). Any material time or cost overruns in the group projects could lead to an increase in the company's borrowing levels and weakening of 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, prices of LPG (Domestic) and SKO (PDS) are under price control, on which the GoI pays subsidy to cover the under recoveries. However, subsidy payment gets delayed often leading to build up of working capital borrowings. Timely receipt of subsidy will be the key to protect the financial profile of public sector OMCs.

Liquidity position: Strong

HPCL's liquidity profile is expected to remain **strong** aided by healthy cash flow generation and sizeable cash and cash equivalents (Rs. 5,955 crore on standalone books as on September 30, 2019). 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

Negative triggers – Downward pressure on HPCL's ratings could arise if a) there is a significant increase in net under-recoveries due to change in Government policies on pricing/subsidy sharing on sensitive petroleum products leading to an erosion in the company's profits and cash flows or b) larger-than-expected debt funded capex resulting in the deterioration in the company's credit profile.

[1] Return on capital employed

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

Key financial indicators (Consolidated - audited)

	FY2018	FY2019	H1 FY2020^
Operating Income (Rs. crore)	219,510	275,473	132,007
PAT (Rs. crore)	7,218	6,691	1,639
OPBDIT/OI (%)	4.9%	4.4%	3.0%
RoCE (%)	22.0%	20.4%	NA
Total Debt/TNW (times)	0.9	0.9	0.9
Total Debt/OPBDIT (times)	2.0	2.3	3.6
Interest Coverage (times)	17.5	15.5	7.6

NA: not available; ^Unaudited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2020) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating 10-Jan-20	Date & Rating 1-Oct-19	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2019 8-Jan-19	Date & Rating in FY2018 29-Mar-18	Date & Rating in FY2018 4-Dec-17	Date & Rating in FY2017 -
1	NCDs	Long Term	7,500	5,500	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
2	Commercial Paper	Short term	15,000	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
3	Cash Credit	Long term	4,000	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
4	Fund Based Limits	Long term	18,254	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-	-
5	Non-Fund Based Limits	Short term	22,746	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
6	Issuer Rating	-	-	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	-

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	-	-	2,000.0	[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.	24.99%	Limited Consolidation
Aavantika Gas Ltd.	49.99%	Limited Consolidation
Petronet India Ltd.	16.00%	Limited Consolidation
Petronet MHB Ltd.	32.72%	Limited Consolidation
Godavari Gas Pvt. 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

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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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